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Experiences of Financial Distress in Thailand

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Rehabilitating the financial institutions that were failing in 1984 appears to have cost the Thai government no more than closing them down and paying off depositors would have cost. In a situation like this, authorities must make a tradeoff between preserving the financial system's well-being and being able to hold managers of failed institutions accountable for their failure.

Between 1983 and 1984, 15 Thai finance companies — with Baht 9.8 billion in assets — went under, and many others were distressed. Authorities were faced with the choice of rescuing the troubled institutions or closing them down. Closing an institution down is often less costly, financially, than rescuing it — and the most effective way to penalize shareholders and management. The risk in closing institutions is that you might set off systemwide panic that hurts both the domestic market and the country's ability to attract foreign funds.

Although some companies failed to recover, the measures Thai authorities took succeeded in restoring public confidence in the system. Deposits in finance companies, which had dropped to their lowest levels in 1984, gradually rose back to normal after the government's intervention — despite problems with inexperienced management, high overhead costs, and the refusal of many former managers of these companies to cooperate with the authorities.

How did the authorities succeed in restoring public confidence? First, in choosing to rehabilitate many financial institutions, the government demonstrated its commitment to preserving

financial institutions as much as possible. Second, changes in the Bank of Thailand Act and the regulations governing commercial banks and finance companies gave the authorities more power to handle problem institutions and prevent further crises.

Rehabilitating these institutions appears to have cost no more than closing them down and paying off depositors would have cost. The April 4, 1984 rehabilitation scheme cost Baht 8 billion. Had these companies not been rescued, the costs of a promissory note exchange, net of a partial recovery from liquidation of assets, would have cost close to Baht 8 billion. And rehabilitation allowed business concerns to continue borrowing from these institutions, strengthened the financial system, and may have allowed shares held by authorities to appreciate.

Of course, the rescue option meant using government facilities and personnel. And it is more difficult to prosecute former managers under a rehabilitation scheme than if the institution closes down. The dilemma authorities face in a situation like this is the tradeoff they must make between preserving the financial system's well-being and preventing moral hazard.

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Experiences of Financial Distress in Thailand*

**by
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Table of Contents

I. Overview of Different Types of Financial Institutions in Thailand	1
II. History of Financial Distress in Financial Institutions	3
III. Types of Intervention by the Authorities and their Rationale	11
IV. Assessment of Results	23
Exhibits	26

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EXPERIENCES OF FINANCIAL DISTRESS IN THAILAND

In the past decade Thailand has seen two crises in financial institutions which had some effects on the economy as a whole. This paper will recount some of this history with an attempt to explain the causes of the problems. It will then describe measures taken by the authorities in response to these problems. Finally an assessment of the effectiveness of these measures will be discussed.

The paper will begin with an overview of the different types of financial institutions in Thailand and their supervisory structure. The second section is on the history of financial distress and its causes. Two cases of crises in finance companies, an early commercial bank case, and three recent commercial bank cases will be discussed. (See exhibit 1 for their data summary.) The third section, on measures taken by the authorities, covers assistance to depositors, rehabilitation programs, legal action against the management, and reforms in regulations and supervision method. The last section will be an evaluation of these measures with respect to the authorities' objectives, namely the restoration of public confidence in the financial system, the rehabilitation of problem financial institutions, and the prevention of future crisis.

I. OVERVIEW OF DIFFERENT TYPES OF FINANCIAL INSTITUTIONS IN THAILAND

Thailand has a substantial number of financial institutions, the majority of which are privately owned. Among the different types of financial institutions, commercial banks are by far the most important,

accounting for over 75 per cent of total deposits and total credits extended. The second largest group consists of finance companies. The remaining groups are life insurance companies, agricultural cooperatives, savings cooperatives, pawnshops, credit foncier companies, and a number of specialized financial institutions. The system also has a substantial non-institutional sector. (See exhibit 2.)

Presently (December 1988), there are 30 commercial banks in Thailand, 16 domestic and 14 foreign, with a total of Baht 1,147 billion in assets and Baht 890 billion in deposits. About 60 per cent of the deposits are time deposits, while the remaining are savings and demand deposits. Approximately one-third of loans are in the form of overdrafts. These advances are normally on a short term basis but may be renewed, in some cases for several years. More than half of the commercial bank credits are extended to the manufacturing sector and the wholesale, retail, and foreign trading sectors. Lending to the agricultural sector amounts to only a small fraction of total credits. Commercial banks can trade foreign exchange but are not permitted to be in the securities business.

Finance companies may not accept deposits in the same form as commercial banks. Rather, these companies borrow funds from the public through the issuance of promissory notes or similar instruments. The interest rates offered on these notes are somewhat higher than deposit rates offered by commercial banks. At present (December 1988), there are more than a hundred finance companies in Thailand, with a total of Baht

196 billion in assets and Baht 117 billion in public borrowings. Two-thirds of credits granted by finance companies are short term. Most of these are call loans and discounting of bills from business and industrial firms. A few finance companies specialize in lease financing and installment credits. Finance companies are not permitted to engage in foreign exchange business. However, some of them have permission to act as securities brokers, dealers, underwriters, and investment advisors. As will be evident later in the paper, the problems faced by finance companies can be a consequence of losses in the securities business as well as poor-quality loans.

Supervision of the commercial banks and finance companies is the responsibility of the Bank of Thailand under the authorization of the Minister of Finance. Among the statutory powers conferred to the Bank of Thailand are the powers to vary the commercial bank legal reserve requirement and finance company liquidity ratio; to prescribe various other ratios pertaining to the operations, such as the capital to risk asset ratios; to set the maximum interest rates on loans, deposits, and promissory notes; and to examine the accounts of commercial banks and finance companies. Generally the Bank of Thailand carries out its policies by exercising the powers it has and by seeking cooperation from members of the banking system. In a number of occasions, however, moral suasion is proven effective.

II. HISTORY OF FINANCIAL DISTRESS IN FINANCIAL INSTITUTIONS

The case of finance companies

The root of the problems in finance companies could be traced to as early as their inception. Before 1972, finance companies merely

had to register with the Ministry of Commerce, and the lack of specific regulations for finance and securities companies made it impossible for the authorities to closely monitor their performances. The first attempt to regulate them was made in 1972. However, securities laws were still inadequate, and the regulations put forth in 1972, which covered other types of businesses as well, were rather general and ineffective. Specifically, the Bank of Thailand had no authority to take over the operations or protect the assets of finance companies in crisis. It was after the first crisis in 1979 that the Act relating to Finance Business, Securities Business and Credit Foncier Business was in effect.

Prior to 1979, finance and securities companies' business growth was very high, but the quality was questionable. Gains on Securities were the main sources of income for these companies, and speculation became widespread. During this period, a major finance company named Raja Finance (Raja) made loans to its affiliates and other clients amounting to Baht 1.1 billion for the purpose of investment in its own shares. Share price rapidly rose in a frenzy of manipulation to 24 times par in November 1978, after which it continuously declined. Intervention by Raja could not support the stock price and eventually led to its liquidity shortage. Fearing repercussions on the overall system, the Ministry of Finance and the Bank of Thailand took control of the company. Raja was, nevertheless, closed down in August 1979, after an unsuccessful attempt to rescue it while coping with the uncooperative attitude of the major owner. The holders of its promissory notes were paid off only 20 per cent of the face

amounts. Even now the authority officials involved are still entangled in a legal battle with the major owner.

The main causes for Raja's downfall were mismanagement of the company, compounded by the widespread speculation and manipulation of stock prices. By lending to clients who used the loans to fund their purchase of Raja's shares, the company was in effect reducing its relative capital, and thus became highly vulnerable to adverse movement in its stock price. In addition, the tightening money markets and higher interest rates contributed further to Raja's liquidity shortage.

Investors of Raja's stock also included a number of other finance companies. Raja's failure undermined the public confidence in the securities system and had repercussions on these other companies as well. Under these circumstances, the situation faced by finance companies became even more serious when the economy at the time was on a down trend.

Although the authorities dealt with the crisis by intervening in the securities market to assure a certain degree of market stability, and by putting forth measures to assist finance companies in their liquidity management, many companies surviving the crisis still suffered from its aftermath. These companies included those having invested in Raja's and other stocks, those having made loans to Raja, and those whose borrowers incurred securities losses during the crisis. The economy during 1981 to 1983 was also weakened by major changes in the world economy, namely the slowing of global demand, the increase in foreign interest rates relative to domestic rates, and the increase in exchange rate volatility.

In trying to capture a larger market share, a number of finance companies did not exercise sufficient care when extending credits, while fraud and mismanagement were rampant in many others. Several companies made loans to affiliates for the benefit of the management and without adequate collateral. Debtor accounts were sometimes falsified to cover up management's embezzlement. These factors led to another crisis in 1983.

The finance company facing greatest difficulty was the Equity Development Trust and Finance (EDT). EDT had made loans to its affiliated firms to buy shares in Rama Tower Hotel, which, in turn, had a deep involvement with Carrian Group in Hong Kong, as Rama Tower and Carrian held shares in one another. Carrian Group experienced a serious problem and was having a severe liquidity shortage. Rama Tower's shares were directly affected. EDT's attempt to support Rama Tower's stock price did not succeed, and the accumulation of carrying costs of funds borrowed for this purpose led to EDT's own liquidity crisis. Since EDT borrowed from several other finance companies, the Bank of Thailand at first tried to avoid closing the company and asked Bangkok Bank, Limited, Thailand's largest commercial bank, to take over EDT. However, further examination showed EDT's financial status to be beyond rescue. EDT and four other related companies were closed down in December 1983.

The magnitude of the second crisis was much greater than that of the 1979 crisis. Between September 1983 and April 1984, 65 finance and securities companies not affiliated to commercial banks had a total of Baht 8 billion of their promissory notes withdrawn by the public, in spite of the joint effort by the authorities and the Thai commercial banks to set up a Baht 5 billion liquidity fund for such companies. In the years

1983 to 1984, a total of 15 finance companies (including securities companies and credit fonciers) with Baht 9.8 billion in assets went under. Only later in 1984, after the Ministry of Finance and the Bank of Thailand announced a plan to take over the ownership and management of a number of finance companies, was the public confidence gradually restored.

Early History of Commercial Banks

Among the early cases of financial distress in banks was the case of the Agricultural Bank in 1959. Founded in 1950, the bank had about Baht 600 million in assets, and specialized in providing financial services to the agricultural and agro-industrial sectors. This concentration made it difficult to diversify the bank's risks. Loans to these sectors were generally riskier than those to other sectors by nature, since the outcome largely depended on factors the bank could not control, such as the climate and global commodity prices. Prior to 1959, the bank had also been increasing its branches rapidly with neither a proper planning nor a sufficiently reliable internal control system. Thus, the management at the head office was unable to assess the entire bank's financial standing in a timely manner. Furthermore, a large volume of loans had been extended to businesses owned by major shareholders of the bank with inadequate collateral. After these businesses failed, the bank experienced a severe liquidity shortage.

The Bank of Thailand responded to the liquidity problem by granting a low interest loan through the Government Savings Bank. A few state enterprises were also requested to maintain non-interest bearing

deposit accounts in the bank. The Ministry of Finance eventually took over the ownership and management of the bank, and its financial status gradually improved. Deposits grew from Baht 300 million in 1959 to Baht 1,300 million in 1964. Later in 1966 the bank was merged with another government-owned bank, the Provincial Bank, to form a single government-owned commercial bank, namely the Krung Thai Bank.

Recent History of Commercial Banks

The Asia Trust Bank (1984)

The Asia Trust Bank (ATB) was founded in 1965 by the Tarnvanichkul family. At the end of June 1984 it had Baht 10.6 billion in assets and Baht 6.3 billion in deposits. The bank normally had a substantial amount of foreign business. Until 1979, its loans and deposits grew at a rapid rate of over 20 per cent each year. A significant portion of loans were made to businesses owned by ATB's major shareholders and most of them without adequate collateral. After 1979 deposits growth began to slow down, while loans growth remained high. Interests on these loans were largely uncollectible, and the bank began to suffer from a liquidity shortage. Under these circumstances, ATB became increasingly dependent on foreign borrowings, and its problem was thus compounded by the rise in foreign interest rates and increasing exchange rate volatility.

In 1983 the Ministry of Finance and the Bank of Thailand appointed an outsider to be in ATB's management team. Evidences of fraud and mismanagement were found shortly after, including the dressing up of accounts to conceal losses, and substantial off-balance sheet commitments

on behalf of a Hong Kong finance company, also owned by the Tarnvanichkul family. The situation was aggravated by internal conflicts, leading to ATB's dismissal of the authorities' appointee in July 1984. Finally a run at ATB in August 1984 prompted the Ministry of Finance to take over the ownership and the management of the bank. Financial assistances in the form of low interest loans and new equity were given, along with a requirement that ATB's capital be reduced from a par value of Baht 100 to Baht 5. (Under the Thailand Civil and Commercial Code, a share must have a minimum par value at Baht 5.) The bank changed its name to Sayam Bank. Subsequently in 1987 most of its assets and liabilities were transferred to the Krung Thai Bank, another government-owned bank, and Sayam Bank ceased its normal operations.

First Bangkok City Bank (1986)

Founded in 1934 by Chinese businessmen in Thailand and taken over twice in 1960 and 1970, First Bangkok City Bank (FBCB) was owned and managed by Mr. Kamron Tejapaibool. The Bank's capital grew from Baht 87 million in 1969 to Baht 1 billion in 1983. It dealt largely with Chinese businessmen both in and outside Thailand, and had a substantial volume of foreign exchange trading. FBCB's management style was highly centralized, with decisions being made solely by the Managing Director.

In 1982 the Bank of Thailand found that FBCB had financial damages up to Baht 5 billion, including Baht 2 billion in loans to Mr. Kamron's business

in Hong Kong which was also under difficulty, and Baht 2.8 billion in exchange losses from speculation. The Bank of Thailand initially responded by changing the management and putting its official on the board. However, FBCB's problems escalated as additional loan losses were identified. In 1986 the Bank of Thailand requested that FBCB's capital be reduced by Baht 1.3 billion, from a par value of Baht 100 to Baht 5. In addition, Baht 2 billion in new capital (only part of which came from the authorities and the rest from private interests) and Baht 3.3 billion in low interest loans were injected, along with an appointment of a new management by the authorities.

Siam City Bank (1987)

The Siam City Bank (Siam City) was founded in 1941 by government officials, royalties, and a few government departments. After two major capital increases in 1965 and 1971 and several ownership reshuffles, the Mahadamrongkul group emerged as the major shareholder group.

By 1982, it was discovered that Siam City had accumulated large losses resulting from bad loans, part of which were made to businesses owned by the bank's major shareholders. By 1983 Siam City was technically insolvent, its capital being negative Baht 380 million. The Bank of Thailand advised Siam City to increase its capital, but internal conflicts prevented it from happening. In 1986 the Bank of Thailand ordered Siam City to increase its capital by Baht 1.5 billion, but the management were unable to do so. Finally in 1987 the Bank of Thailand requested that Siam City's capital be reduced from a par value of Baht 100 to Baht 5, along with a capital increase of the size Baht 1.5 billion. Most of the capital increase was subscribed by the public due to favorable performance of FBCB's share prices after the intervention.

III. TYPES OF INTERVENTION BY THE AUTHORITIES AND THEIR RATIONALE

There is no unique solution to the problem of financial distress. Nor is there one single indicator as to whether a financial institution in trouble should be rescued or closed down. Both options entail certain advantages and disadvantages. Closing down an institution is often the least costly solution in financial terms and offers the most effective way to penalize the shareholders and management. However, by choosing this option, the authorities risk having a system-wide panic which can affect not only the domestic credit market but also the country's reputation much needed to ensure the availability of foreign sources of funds. On the other hand, while the decision to rescue an ailing firm should minimize the potential for a panic, the costs of rescue could be very high and the final outcome questionable. Furthermore, using this type of solution frequently may give rise to moral hazard in the financial system. Thus, an optimal decision in each case depends not only on the financial factors but also on the social, economic, and political factors.

Problems with commercial banks are usually coped with by using some form of financial assistance or management restructuring or both, rather than permitting the institutions to fail. There are a number of reasons for this practice. First is the fact that the problems the banks faced in the past often occurred in the middle of an economic downturn and when the whole financial system was vulnerable to shocks and increasingly volatile environment. Furthermore, there was already a large non-institutional

financial sector. Although the total deposits in this sector could not be accurately estimated, they were believed to be quite substantial. At one time in 1984 - 1985, there were a few big pools of such informal funds, each of which could mobilize funds up to Baht 8 billion (about the volume of a mid-size commercial bank deposits). The authorities feared that a failure of a relatively large financial institution might destroy the public confidence in the institutional financial system to the extent that the confidence in the foreign exchange market would also be eroded and the country's credit rating impaired. Also of importance is the fact that throughout history, never has a commercial bank been permitted to fail. Thus, to let a commercial bank fail would be a very tough decision for the Finance Minister or the Bank of Thailand Governor.

In the case of finance companies, historical evidence shows that the authorities handled the problems by closing the companies and revoking their licenses in about as many cases as by giving financial or managerial assistance. Among the finance, securities, and credit foncier companies facing severe hardship between 1979 and 1988, 5 were given financial assistance with the majority of their policy decisions remaining independent from the authorities, 25 were given financial assistance while the authorities temporarily took over the management and ownership, and 28 were closed down and had their licenses revoked by the authorities. Why the option of letting a finance company fail is more feasible than it is in the case of commercial banks can be explained as follows. Although the authorities are concerned about a system-wide panic, the sizes of finance companies affected tend to be

quite small relative to the sizes of commercial banks, and if a finance company were to fail, its impact on the financial system should be less pronounced than that of a bank failure. Therefore it is generally easier to let a finance company fail, especially when the decision can be justified by a financial cost and benefit comparison. Raja Finance in 1979, for example, had only Baht 198 million in valuable and uncollateralized assets, while its net creditors' position was Baht 643 million, and it was evident then that the company could not easily be salvaged. Furthermore, Raja's closure in 1979 set a precedent for subsequent cases, making closing a finance company a viable alternative.

Assistance to the Depositors in the Event of Closure

When the Raja crisis occurred in 1979, the holders of Raja's promissory notes were paid only 20 per cent of the face values, since the authorities were not prepared to compensate them fully then. However, the depositors of other finance companies that were subsequently closed down were treated more favorably through a promissory note exchange program.

In the early phase of this program, 4 finance companies were chosen by the authorities to be the exchangers. The exchange was done according to the following procedure. The holders of a closed finance company's promissory notes exchanged these notes for a series of promissory notes issued by the exchangers. The total face values were the same as before, but the maturities were spreaded out over a period of up to 10 years, and no interest was paid. The exchangers were compensated with a low interest rate loan from the Bank of Thailand, collateralized by government

bonds. The exchangers' losses from the exchanging of promissory notes were offset by the net gains from the interests of the bonds. Later on when the Financial Institutions Development Fund (FIDF) (mentioned later in detail) was formed, it took over the function of the exchanger of promissory notes in the event of finance company closure. The procedure is the same as before, except the cost of exchanging the notes is now fully borne by the FIDF.

There are three major characteristics of the promissory note exchange program. The first is that the promissory notes held by the management of the closed institution and related parties (including affiliated firms) are not eligible for the program. The second is that the authorities make their total costs supportable by extending the repayment periods over 10 years without interest. The third lies in the structure of the repayment itself. Basically each depositor will receive no more than 10 new notes, each with a face value of one-tenth of the original amount. However, the face value of the new note maturing in the first year must be at least Baht 50,000 (or the original amount if it is already less than Baht 50,000). Thus, all depositors will be paid off in no more than 10 years, but the repayment is relatively faster for smaller depositors. Particularly, those with Baht 50,000 or less will be paid within a year. These people account for almost 90 per cent of the total number of depositors. This method implies that the authorities give higher priority to smaller depositors.

Rehabilitation of Finance Companies

Finance companies in crisis but not closed down by the authorities are restored by way of financial and managerial assistance. The degree of involvement by the authorities varies from a mere financial assistance with minimal management involvement, to a management and ownership takeover for a relatively longer term, depending on the magnitude of the problem and available resources from other members of the financial market.

When there is another financial institution, domestic or foreign, expressing interest in the finance company in crisis, and when the rehabilitation plan proposed by that party is acceptable to the authorities, it is likely that the authorities would opt for a takeover of the finance company by that party. Several cases were handled in this manner, and in most of them financial assistance was also given to the finance company under the new management, usually in the form of a low interest rate loan.

If there is no outside interest for the ailing finance company, the authorities may decide to take control of the company temporarily, and when the owners or former management come up with an acceptable rehabilitation plan, the company can be released. In choosing this option the authorities may end up closing the company eventually if no rehabilitation plan can be agreed upon and no merger party can be found.

Rehabilitation plans that have worked in the past generally incorporate the following features. The first is an injection of new

capital, which may have to be substantial if the size of problem loan is large. If the new capital is brought in by new investors, they may require a prior capital reduction to offset some retained losses. In some cases where new investors are not readily available, the authorities may have to help subscribe to the new issues partially. The second is a business plan to bring in additional revenues. The third is a proposal to control the level of operating costs and to cut back the unnecessary items, as well as to improve the accounting and internal control systems. The fourth is a problem loan recovery plan, and, to the extent that recovery is not possible, a write-off plan. Lastly, a team of professional management must be submitted for the authorities' consideration. The rationale is that the company under rehabilitation should return to health in a reasonable period of time, without having to turn to the authorities for assistance repeatedly.

Several finance companies in the 1983 - 1984 crisis, however, could not be rescued by outside, private parties in such manners, since there was not another party interested in taking over these companies at the time, and since they could not come up with a rehabilitation plan satisfactory enough to warrant financial assistance from the authorities. At the same time, fearing that a system-wide panic could be disastrous, the authorities did not want to respond by closing down these finance companies. Their action, then, was to announce a group rehabilitation program run by the Ministry of Finance, later known as the April 4, 1984 Scheme after the announcement date. Twenty-five finance companies were

admitted into the program. Together they had Baht 15.3 billion in assets, roughly half of which were non-performing.

The main feature of the April 4, 1984 Scheme was the stipulation that the owners of the companies joining the Scheme had to cooperate with the authorities and accept conditions imposed upon them. These conditions included a transfer of at least 25 per cent of the companies' shares to the Ministry of Finance at minimal nominal prices and a transfer of additional voting rights sufficient to give the authorities management control of these companies. In addition, the former owners were held responsible for the losses arising from the loans that had been made to affiliated firms which they also owned, and therefore had to put up their own assets as collateral for these loans. It was also agreed that the major shareholders would be responsible for all the burdens of the companies, including those which were not known then but which might become evident later.

The authorities, in turn, would guarantee the entire principals and interests of all promissory notes held by the public. Financial assistances in the form of long-term low interest rate loans from the Bank of Thailand, overdraft facilities at the Krung Thai Bank, and equity participations by the authorities were also given. The authorities appointed their officials to take over or assist with the management of the companies and to improve the internal control systems. After recovery, the authorities could sell their shares to the public, or to the former owners if they could demonstrate their management capabilities to the satisfaction of the authorities. Five of the 25 companies that joined the Scheme were released in this latter manner.

The authorities also encourage mergers of small finance companies to form a large finance company in order to benefit from the economy of scale as well as to use the country's management resources more efficiently. There were two such mergers within the companies joining the Scheme, one among six companies and the other among three. These mergers were desirable because the companies within each group shared a common group of owners and made loans to the same group of affiliates.

Rehabilitation of Commercial Banks

The first step toward the restoration of a problem bank with large accumulated losses is usually an order from the Bank of Thailand, requiring the problem bank to raise additional capital to strengthen its financial position and build a base for future revenues. However, a capital increase can be difficult to accomplish, because potential investors may be reluctant to share the previously incurred losses. In such cases, the Bank of Thailand will order the problem bank to reduce the par value of its shares (usually from a par value of Baht 100 to Baht 5 which is the minimum possible), while the number of shares remains the same, so that the reduction in capital can partially offset the accumulated losses before new shares are issued. This method of officially reducing the capital before issuing new shares has also been used with the finance companies joining the April 4, 1984 Scheme. After the capital reduction, if the problem bank still cannot raise new capital as required, the authorities may subscribe to some of the new shares through the Financial Institutions Development Fund.

For commercial banks (as well as finance companies) in trouble, one of the most often used forms of financial assistance from the government is the low interest rate loan fully secured by government bonds, also known as the "soft loan". The bank receiving a soft loan benefits from the difference between the interests on the government bonds and the interests charged on the soft loan (normally very low at around 0.1%), and the entire principal amount is guaranteed to the lender (usually the Bank of Thailand). The rationale for this type of assistance to supplement the capital injection is that, in most cases, even after a capital reduction is imposed upon the former owners, the accumulated losses still have not been fully offset, and the public may need additional incentives to subscribe to the new shares being issued. The soft loan can function as one such enticement.

A variation of the soft loan is what is known as the "conditional loan", given to the Bank of Asia in 1987. This bank did not want to dilute its ownership structure by selling its new issues to the public. Rather, it opted for a private capital increase among the same shareholders. Therefore, a soft loan to this bank could not be justified on the grounds of being a necessary enticement for public investors. An additional condition was imposed upon the borrower, hence the name "conditional loan". The condition is that Bank of Asia had to return to the authorities some of the benefit from this loan by allowing the FIDF to buy a certain portion of its subsequent issues at par.

Whether or not a soft loan can be successfully provided depends on a number of factors. First of all, the amount of the soft loan must

be substantial enough for its benefit to be meaningful. At least the net interests received by the company should be able to stop the bleeding due to the carrying costs of non-performing assets. The company must also create additional profits from operations so that it can return to normalcy and stand on its own after the term of the soft loan is over. The quality of the management is crucial, since the management is responsible for forming strategic and business plans to achieve this objective as well as putting the plans into effect.

The authorities, therefore, have given significant management assistance to the problem banks. In most cases, professionals from the private sector were appointed to take over or assist with the management and to improve the internal control systems. Government officials were also appointed when necessary.

Legal Action Against the Management of Problem Financial Institutions

Several lawsuits have been brought by the Bank of Thailand as well as the private sector against the management of problem banks and finance companies suspected of fraud and embezzlement. Because of the past limitation in statutory powers given to the authorities, the result has been far from successful. Of the 222 suspects in the case of finance companies as of April 1988, only 31 have been brought to the court level, of which only 5 have been found guilty, while 26 still remain under prosecution. Also, many suspects under investigation by state attorneys have left the country.

In response to this problem, and in order to enable the authorities to make timely intervention in the future, the laws concerning financial institutions were amended in 1985. The amendments mainly cover the following aspects:

1) Information disclosure and examination

- Financial institutions are required to disclose their financial statements to the public every six months.
- The auditors of the statements must be approved by the Bank of Thailand.
- Examiners and other related officials are given more authority in the inspection of financial institutions.

2) Prevention of damages

- The Bank of Thailand can order a financial institution to make operational changes when there are sufficient evidences that such changes are necessary to prevent public damages.
- The Bank of Thailand can order a financial institution to make adequate provision for loan losses and other doubtful assets.
- The Bank of Thailand can order a financial institution to reduce its capital value, to raise additional capital, and to change the management, when there are sufficient evidences that such action is necessary.
- The Finance Minister can order a financial institution to cease all or part of its operations temporarily in the case of a crisis.

3) Prosecution of the management for their wrongdoings

- The authorities have the power to seize the assets of any person suspected of fraud or embezzlement temporarily until a court verdict has been reached, and to prohibit the suspect from leaving the country.

.. The officials appointed by the authorities can represent the public in the prosecution of the management suspected of fraud or embezzlement.

Formation of the Financial Institutions Development Fund

In addition to the previously mentioned amendments, another amendment was made at the same time to the Bank of Thailand Act, with an aim to allow the Bank of Thailand greater flexibility in giving financial assistance to financial institutions in distress. Through this amendment, the Financial Institutions Development Fund (FIDF) was formed within the Bank of Thailand. Its legal status is that of a juristic person, and its stated purposes are to restore ailing financial institutions to good condition, and to bring about strength and stability in the financial system. The FIDF has its own board of directors separate from the Bank of Thailand, but its operations are handled by the staffs of the Bank.

Statutory powers given to the FIDF include the powers to invest in short-term securities; to hold deposits in financial institutions; to lend to financial institutions with collateral; to purchase assets from and to buy and hold shares in financial institutions; and to give financial assistance to the depositors of a failing institution. Its sources of funds come from the mandatory contributions from financial institutions (currently set at the annual rate of 0.1 % of deposits), as well as from the participations and advances from the Bank of Thailand as the Bank deems appropriate.

While there is no explicit deposit insurance scheme as such, depositors receive an implicit protection through the operations of the FIDF. A full-fledged deposit insurance scheme is under consideration, but its concept and design still call for further study.

Improvement in the Supervision and Examination of Financial Institutions

Examination in the past used to be performed at all offices and branches and in all possible aspects. Therefore it was almost impossible for the examiners to look into any particular area in depth. After the crises, the Bank of Thailand has turned to selective examination, with an emphasis on the quality of assets and targeting the main offices, to improve the effectiveness of examination. To this end, the examiners are empowered by law in the case of finance companies to examine also their debtors. Furthermore, the supervisory authorities have been paying greater attention to the management of financial institutions and have tried to replace family-style management with professional management whenever possible.

IV. ASSESSMENT OF RESULTS

Measures taken by the authorities have been especially successful in the restoration of public confidence in the financial system. Deposits in finance companies, which had dropped to their lowest levels in 1984, gradually rose back to normal after the government's intervention. (See exhibit 3.) Although the pattern is not so obvious in the case of commercial banks due to the relatively small sizes of banks affected, as a whole, there are fewer problem institutions, and the role and importance of the non-institutional financial sector have been greatly reduced.

The authorities' success in restoring public confidence can be mainly attributed to two factors. One is that, by choosing to rehabilitate the financial institutions (which was the choice in many cases), the government demonstrated its commitment to the preservation of financial institutions to the extent possible. The other is that there have been a significant number of changes in the Bank of Thailand Act and the regulations of commercial banks and finance companies, allowing the authorities more capacity to handle problem institutions and to prevent future crisis.

The rehabilitation program itself has had a number of obstacles but is still considered to be moderately successful. First Bangkok City Bank has been making profits since 1987, and Siam City Bank since the second half of 1987. Among the 25 finance companies in the April 4, 1984 Scheme, 5 were already released back to the former owners. As for those finance companies unable to regain their strengths according to the plan, their inferior performances have been a result of having large non-performing assets with collaterals that could not be easily liquidated. Many former managers of these companies refused to cooperate with the authorities, thus making it difficult to recover the loans made to these managers and their other businesses. Other obstacles to the rehabilitation program include the lack of experienced professional managers and the high overhead costs resulting from the inability to reduce the number of unqualified employees.

The efficiency of the rehabilitation measures can be assessed by comparing the costs and benefits of this program with what would

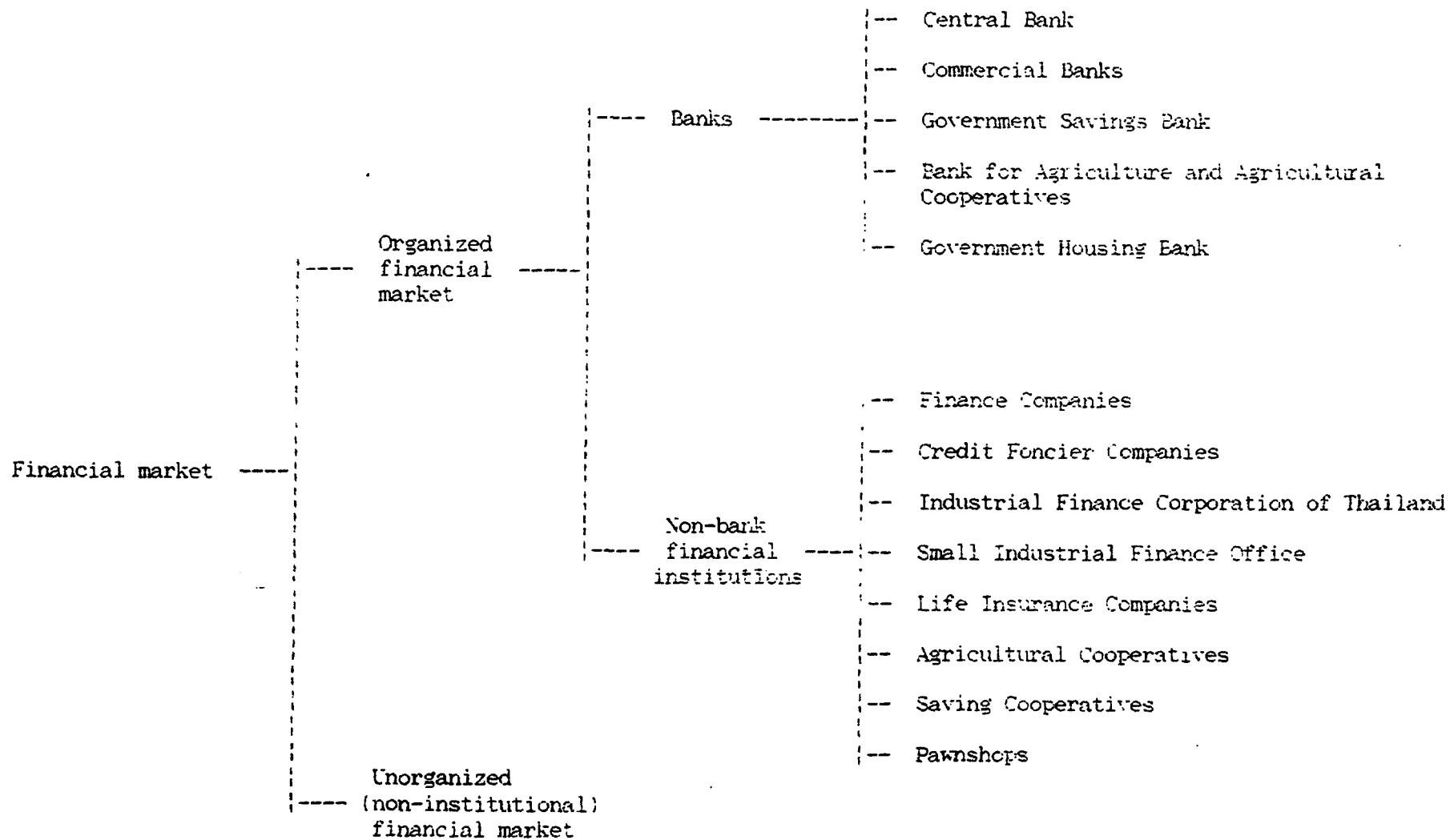
have been, had the authorities allowed these institutions to fail and close down. In the case of the April 4, 1984 Scheme, the costs to complete the program, as estimated from the interest expenses and opportunity costs borne by the authorities and valued at the time of the crisis in 1984, would be approximately Baht 8 billion. Had these companies not been rescued, the costs of a promissory note exchange program, net of a partial recovery from the liquidation of assets, also valued at the time of the crisis, would have been close to the same amount of about Baht 8 billion. Thus it appears that the costs of rehabilitating these institutions are quite the same as the costs of closing them down and paying off the depositors. Furthermore, there are some other benefits unique to the rehabilitation option, namely the continuation of the business concerns which borrow from these institutions, the strength of the financial system, and the possible gain from the appreciation of shares held by the authorities.

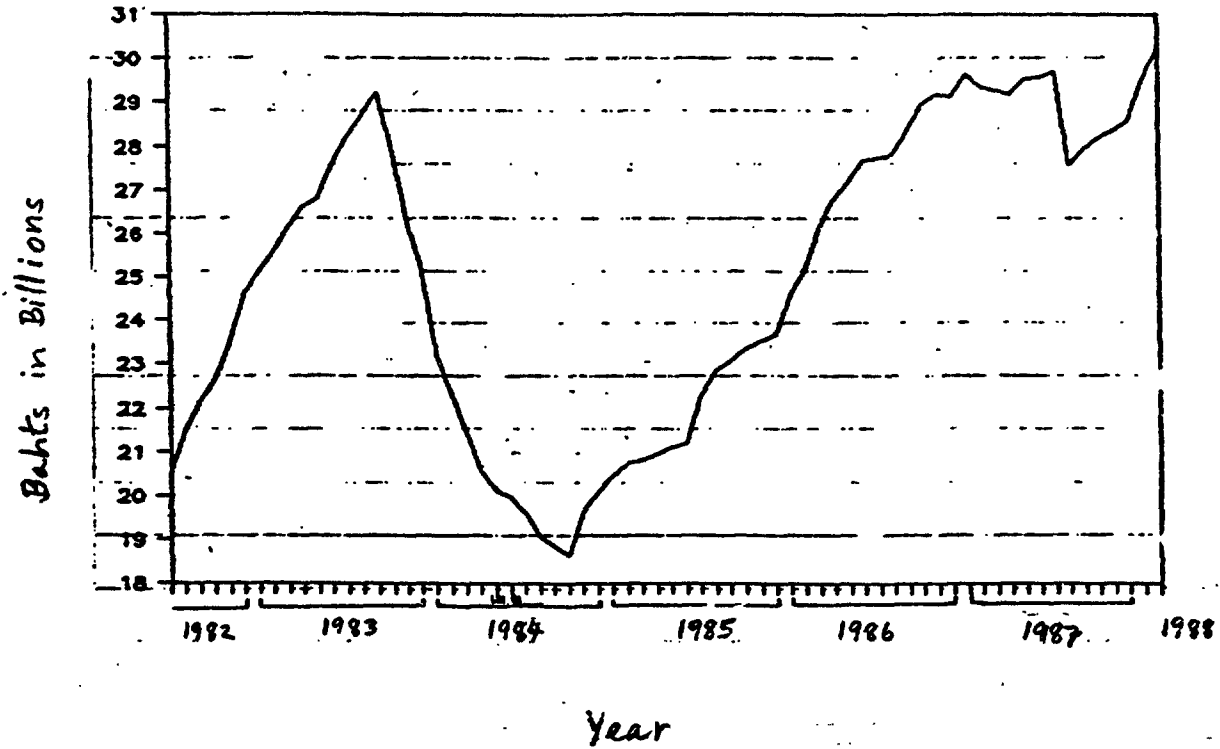
Rehabilitation unfortunately has other costs and disadvantages. The most obvious one is the cost of using government facilities and human resources in the rescue. Less direct but also important is the fact that, when a rehabilitation program takes place, it is more difficult to prosecute the former management than it would be if the institution were closed. Inevitably in many cases, the authorities were unable to punish the guilty parties through the legal channels, thereby indirectly and unintentionally encouraging unscrupulous managers to take advantage of the lack of market and legal discipline. The trade-off between the objectives of preserving the financial system's well-being and preventing moral hazard, therefore, will probably continue to pose a difficult issue for the authorities in each case of financial distress to come.

Exhibit 1 : Summary of Financial Distress History

	Size of total assets (million Baht)	Size relative to financial system	Major causes of crisis	Types of intervention
Finance Companies				
Raja Finance (1978)	2,319	9.7 %	- Securities losses - Margin loan losses - Mismanagement	- Closure - Partial repayment to depositors - Liquidity assistance to other finance and securities companies
ST Finance, Finance & Securities and Credit Foncier Companies (1980 - 1984)	34,495	5.4 %	- Repercussions from Raja crisis - Economic downturn - Loan losses - Fraud - Mismanagement	- Closure (39 companies) - B/N exchange program for depositors - Liquidity assistance - Temporary takeover by the authorities (28 companies) - Financial assistance (low interest loans and equity injection) - Management change
Commercial Banks				
Agricultural Bank (1980)	800	3.2 %	- Excessive growth - Loan losses - Mismanagement	- Liquidity assistance - Financial assistance (low interest loans) - Ownership and management takeover by the authorities - Eventual merger with another government-owned bank
Asia Trust Bank (1984)	11,287	1.5 %	- Loan losses - Exchange losses from large foreign borrowings - Fraud - Mismanagement	- Reduction of capital value - Financial assistance (low interest loans and equity injection) - Ownership and management takeover by the authorities - Eventual merger with another government-owned bank
First Bangkok City Bank (1986)	25,957	2.9 %	- Loan losses - Exchange losses from trading - Fraud - Mismanagement	- Reduction of capital value - Financial assistance (low interest loans and equity injection) - Management change
Siam City Bank (1987)	29,584	3.6 %	- Loan losses - Mismanagement	- Reduction of capital value - Equity increase mostly by the public - Financial assistance (low interest loans) - Management change

Exhibit 2 : Structure of the Financial System in Thailand





Borrowings from the public by finance and credit foncier companies not affiliated to commercial banks

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