THAILAND’S EXPERIENCE OF BANKING AND FINANCIAL SECTOR REFORM AFTER THE CRISIS

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BANK OF THAILAND

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LESSONS FROM THE PAST DECADE AND WAY FORWARD
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Thailand’s Experience of Banking and Financial Sector Reform after the Crisis

Assistant Governor, Mr. Krirk Vanikkul

Bank of Thailand

17 December 2007
I. Overview of banking system from crisis up to now (1997 – 2007)

II. Regulatory & Supervisory reforms (1997 – 2007)

   Stage 1: cleaning up balance sheet and regulatory changes (1997 – 2001)
   Stage 2: starting to making profit (2001 – 2007)
      - moving to risk-based management & supervision
      - consolidated supervision
      - migration into more consumer lending and more focus on consumer protection
      - IAS 39

III. Retrenching the system and preparation for the future (2004 – 2007)

   - FSMP 1 (2004 – Beginning of 2007) : catalyst for merger & acquisition
   - FSAP (the end of 2004 - 2007) : mapping our system to the international standards
   - FSMP 2 (2008) : how to go forward
   - New FI Laws (FIBA, DIA, and BOT Act) : legal recognition of past developments and for future changes
   - BASEL II : go with the flow in the EMEAP groups
I. Overview of banking system from crisis up to now (1997 – 2007)
Overview of Banking system

Profit & Loss

Profitability

NPLs of Banking System

Capital Adequacy Ratio (CAR)

- Full Branch
- Registered in Thailand
- % Net NPLs / Total Loans
- % Gross NPLs / Total Loans

% of avg. net total assets

Net Interest Margin

Operating profit

ROA

Minimum Requirement for CAR = 8.5
## ROA of Banking System

### Drop in 2006 owing to introduction of IAS 39

<table>
<thead>
<tr>
<th>Country</th>
<th>02</th>
<th>03</th>
<th>04</th>
<th>05</th>
<th>06</th>
<th>07 (March)</th>
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<tbody>
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<td>n.a.</td>
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<tr>
<td>Australia</td>
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<td>1.5</td>
<td>1.8</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

1/ Source : Global Financial Stability Report (September 2007), IMF
Consumer loan / Total loan = 23.1%
Corporate loan / Total loan = 76.9%
### Chronology of Incidents Measures (Dual Crisis = Economic + Financial)

<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
</tr>
</thead>
</table>
| May 1996 | - 1\textsuperscript{st} Bank run on BBC and intervention (beginning of May 1996)  
       | - Baht was being attacked a number of times                             |
| 1997     | - 2\textsuperscript{nd} Bank run on 58 finance companies and intervention (3 March – August 1997)  
<pre><code>   | - Baht was floated from 25 to 45 baht per US$ (December 1997)           |
</code></pre>
<p>|          | - Issued blanket guarantee for depositors &amp; creditors (5 August 1997)    |
|          | - Set up FRA + AMC (National AMC) to deal with 58 finance companies     |
|          | (56 closed down + 2 survived). A year later FRA started to sell assets. |
|          | - Intervened on BMB (November 1997)                                      |</p>
<table>
<thead>
<tr>
<th>1998 – 1999 (continued)</th>
<th>- Recapitalized intervened FIs.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>- Established the Corporate Debt Restructuring Advisory Committee (CDRAC).</td>
</tr>
<tr>
<td></td>
<td>- Issued an Emergency Decree to set up Private AMC to accelerate restructuring of FIs.</td>
</tr>
<tr>
<td></td>
<td>- Amended Bankruptcy Act and approved for the setting of the Central Bankruptcy Court in 1999.</td>
</tr>
<tr>
<td></td>
<td>- Issued new loan classification, provisioning and interest recognition rules (new 6 categories and new interest recognition)</td>
</tr>
<tr>
<td></td>
<td>- Allowed the use of hybrid capital instruments to recapitalize.</td>
</tr>
<tr>
<td></td>
<td>- Issued policies and measures to encourage debt restructuring.</td>
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</table>
### Chronology of Incidents Measures
*(Dual Crisis = Economic + Financial)*

<table>
<thead>
<tr>
<th>Period</th>
<th>Measures</th>
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<tbody>
<tr>
<td>June 2001</td>
<td>- Setting up of TAMC</td>
</tr>
</tbody>
</table>
| 2002 - 2004 | - Amended definition of NPLs and regulation on loan classification and provisioning.  
              - Established a credit bureau.  
              - Privatized intervened FIs. (2 Banks). |
| 2005 - 2007 | - The Cabinet approved the merger of the National AMC and the Bangkok Commercial Asset Management Co., Ltd. (BAM) FIDF in order to purchase NPLs and NPA from FIs. |

- **1998 – 2002** Recapitalization of State-Owned Banks by the Authorities up to 716,929 million baht (by direct equity injection, debt/equity conversion, and reversal of reserves from NPL transfer).
- **2002 – 2007** Tier 1 recapitalization of banks up to 253,018 million baht (by public and private placement, conversion of convertible instruments, and issuance of hybrid instruments). See details in slide 14.
II. Regulatory & Supervisory Reforms

(1997 – 2007)
Changing Financial Landscape

Pre-Financial Crisis, January 31, 1997

1. Commercial Banks (31)
   - Locally-incorporated (15)
   - Foreign bank branches (16)
2. International Banking Facilities (IBFs) attached to commercial banks (25)
3. Stand-alone IBFs (17)
4. Finance and Securities Companies (91)
5. Credit Foncier (12)

Total Number of Financial Institutions: 176

Post-Financial Crisis, December 31, 2003

1. Commercial Banks (31)
   - Locally-incorporated (13)
   - Foreign bank branches (18)
2. International Banking Facilities (IBFs) attached to commercial banks (24)
3. Stand-alone IBFs (5)
4. Finance and Securities Companies (18)
5. Credit Foncier (5)

Total Number of Financial Institutions: 83
### Loan Classification & Provisioning

#### Stage 1: Cleaning up balance sheet and regulatory changes

<table>
<thead>
<tr>
<th>Loan Classification</th>
<th>Before 1997</th>
<th>After 1997</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Aging</td>
<td>Provisioning</td>
</tr>
<tr>
<td>1. Pass</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>2. Special mention</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>3. Substandard</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>more than 6 months</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>more than 12 months</td>
<td>100%</td>
</tr>
<tr>
<td>4. Doubtful (no collateral)</td>
<td>more than 12 months</td>
<td>100%</td>
</tr>
<tr>
<td>5. Doubtful of loss</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>6. Loss</td>
<td>worthless or irrecoverable assets</td>
<td>written off</td>
</tr>
</tbody>
</table>
Recapitalization & Opening up to foreign ownership

<table>
<thead>
<tr>
<th>Banks (Tier 1)</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007 9 m</th>
<th>Remark</th>
</tr>
</thead>
<tbody>
<tr>
<td>State – owned banks</td>
<td>13,164</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4,479</td>
<td>Public Placement</td>
</tr>
<tr>
<td>Large private – owned banks</td>
<td></td>
<td>5,363</td>
<td>2,207</td>
<td>1,707</td>
<td>-</td>
<td>-</td>
<td>Conversion of convertible instruments and issuance of hybrid instruments, but nearly paid back</td>
</tr>
<tr>
<td>Other private – owned banks</td>
<td>7,839</td>
<td>74,050</td>
<td>56,983</td>
<td>29,327</td>
<td>20,677</td>
<td>37,222</td>
<td>Public Placement, Private Placement, and issuance of hybrid instruments</td>
</tr>
</tbody>
</table>

- Regulatory total BIS ratio maintained at 8.5% (Tier 1 = 4.25%), but the average actual ratio stands at 15.1% (Tier 1 = 12.5%) as of Q3 / 2007.

- Foreign ownership 25% → 100% for 10 years, after which foreign ownership cannot be raised until capital increase has been diluted to below 49%.
  Thereafter, the foreign stake can be increased up until the limit of 49%.

- Sales of distress assets to investors and AMCs.
Stage 2: Starting to make profit (2001 – 2007)

Moving to risk-based management & supervision

- Risk - based supervision
  1. Strategic risk
  2. Liquidity risk
  3. Credit risk
  4. Market risk
  5. Operational risk

- Consolidated supervision
  - Migration into more consumer lending
    - Regulatory change consumers protection

  - Derivative products on the rise
  - Entrenching market and counterparty risk management

  - BASEL I (1988) until end of 2008

- Market risk management (1996)
  - Sound Practice of the Management and Supervision of Operational Risk
IAS 39 Implementation for provisioning

- Asset side
- Phasing-in Period (From End-2006 to End-2007)

Asset Classification

(Both Quantitative & Qualitative Criteria)

- Pass
- Special Mention
- Substandard
- Doubtful
- Doubtful Loss
- Loss

Provisioning

- 1% 
- 2% 
- 100%
- Write-off

Provisioning & Collateral

1) PVCF of Debt
2) PV of Collateral
3) Historical loss rate
   (or Collective approach)
III. Retrenching the system and preparation for the future

(2004 – 2007)
FSMP 1
(2004 – beginning of 2007)

I. Measures to broaden general access to financial services
   - In Urban Areas
   - In Rural Areas

II. Measures to increase efficiency of the financial sector
    - Rationalizing the structure and roles of financial institutions
      - Thai FIs
      - Foreign-owned FIs
      - One Presence Policy
      - Risk-weightings for SMEs and Retail customers
    - Streamlining rules and regulations

III. Measures to protect consumers
     - Enhancing transparency and information disclosure
     - Constructing consumer feedback/complaint mechanisms
Financial Landscape before FSMP*

Thai commercial banks 13
Foreign Bank branches 18
IBFs attached to commercial banks 24
Stand-alone IBFs 5
Finance companies 18
Credit fonciers 5

Total 83
Average asset = 86 bil. baht

Financial Landscape post FSMP

1. Thai commercial banks 14
   - all of them are approved financial conglomerates
2. Retail banks 3
3. Foreign Bank branches 17
4. Subsidiary 1
5. Finance companies 5
6. Credit fonciers 3

Total 43
Average asset = 209 bil. baht

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* As of 31 Dec 2003
** Including merger between UOB Radanasin Bank PCL; and Bank of Asia PCL and between GE Money and Retail Bank with BAY
# FSAP in Thailand (the end of 2004 – 2007)

<table>
<thead>
<tr>
<th>FSAP Preparation</th>
<th>ROSCs / FSAP</th>
<th>Development Issues</th>
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</thead>
<tbody>
<tr>
<td>▪ Preliminary assessment</td>
<td>▪ Banking supervision</td>
<td>▪ Insurance and pensions</td>
</tr>
<tr>
<td>▪ Consultation with TA</td>
<td>▪ Securities market</td>
<td>▪ Housing finance and access to finance</td>
</tr>
<tr>
<td>▪ Changes and improvements</td>
<td>▪ Payment systems</td>
<td>▪ Specialized Financial Institutions (SFIs)</td>
</tr>
<tr>
<td>▪ Final decision</td>
<td>▪ Monetary policy transparency</td>
<td>▪ Legal issues</td>
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<tr>
<td></td>
<td>▪ AML / CFT</td>
<td>▪ Capital market development</td>
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<tr>
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<td>▪ Stress testing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Banking sector</td>
</tr>
</tbody>
</table>

**Note**: Preparatory period started in 2005
Objectives

- Improve efficiency, competitiveness, and resiliency of the financial sector
- Promote financial access

Pillar 1
Reduce operating costs

Pillar 2
Increase Efficiency & Competition

Pillar 3
Strengthen Institutional Infrastructures

Note: Preparation period started in 2007
Areas of policy measures in FSMP-II: 10 Loops

- Cost reduction: relaxation of rules and regulations
- Future financial landscape
- Enhance competition and efficiency
- Legal Framework
- Information system, transparency, and enhanced market discipline
- Risk transfer mechanism
- Financial access (esp. role of SFIs)
- Human resource development
- Payment system
- Corporate social responsibility
Pillar I
Minimum Capital Requirements

Calculation of minimum capital requirements on
- Credit risk
- Operational risk
- Trading Book Issues (including market risk)

Pillar II
Supervisory Review Process

Four key principles :
1. Banks’ Own Assessment of Capital Adequacy (ICAAP)
2. Supervisory Review Process
3. Capital Above Regulatory Minimum
4. Supervisory Intervention

Pillar III
Market Discipline

Disclosure of information; e.g.
- Capital adequacy
- Risk management process (including credit risk, market risk, operational risk, IRRB).
### Basel II Implementation Timeframe

- **BOT to issue the final draft of Policy Statement**: Q1, 2006
- **AIRB Approval process**
  - Q3, 2007
  - Dec, 2008
  - Q3, 2009
  - Dec, 2010
- **SA/FIRB Approval process**
  - Dec, 2009
- **Banks submit preliminary implementation plans**: June, 2006
- **Banks submit final application**
  - Sep-Dec, 2007
- **Operational risk**
  - **BIA / SA**
    - PC
    - X
    - X
    - X
  - **Credit risk**
    - **SSA / SA**
      - PC
      - X
      - X
      - X
    - **FIRB**
      - PC
      - X (95%)
      - X (90%)
      - X (80%)
    - **AIRB**
      - PC
      - PC
      - X (90%)
      - X (80%)

**PC** = Parallel Calculation  
**X** = implementation year  
**xx%** = Floor