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The Asian Financial Crisis and the Deregulation and Liberalization of Thailand's Financial Services Sector: Barbarians at the Gate

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Abstract

The recent financial crisis experienced by Thailand and the other Asia-Pacific countries has left an indelible impact on Thailand's financial system including significant amendments to the laws and regulations of banking, finance, and securities business as well as proposed new laws such as the Derivative Act. In this connection, the financial crisis acts as a change agent that promotes and accelerates the pace of deregulation and liberalization. The "barbarians" are the foreign financial institutions and foreign investors who will be in the position to gain the most from an opening of the gate to the financial services sector in Thailand. This Article first presents the background of the financial services in Thailand before examining significant changes to the existing regulatory framework and the legal environment.

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BARBARIANS AT THE GATE

*Apisith John Sutham**

INTRODUCTION

The recent financial crisis experienced by Thailand and the other Asia-Pacific countries has left an indelible impact on Thailand's financial system including significant amendments to the laws and regulations of banking, finance, and securities business as well as proposed new laws such as the Derivative Act. In this connection, the financial crisis acts as a change agent that promotes and accelerates the pace of deregulation and liberalization. The "barbarians" are the foreign financial institutions and foreign investors who will be in the position to gain the most from an opening of the gate to the financial services sector in Thailand. This Article first presents the background of the financial services in Thailand before examining significant changes to the existing regulatory framework and the legal environment.

Broadly speaking, the most important regulations governing the financial services sector in Thailand regulate finance companies, commercial banks, and securities companies. Finance companies are governed by the Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business B.E. 2522 (1979) ("FSCA").¹ Commercial banks are governed by the

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1. Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business, B.E. 2522 (1979) (published in Government Gazette, vol. 96, pt. 74, special vol., May 9, B.E. 2522 (1979)) [hereinafter FSCA] *as amended by* The Emergency Decree Amending the Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business, B.E. 2522, B.E. 2526 (1983) (published in Government Gazette, vol. 100, pt. 195, special vol., Dec. 15, B.E. 2526 (1983)) *as amended by* The Emergency Decree Amending the Act on the Undertaking of Finance Business, Securi-

Commercial Banking Act B.E. 2505 (1962) as amended ("Commercial Banking Act").² Securities companies are governed by the Securities and Exchange Act B.E. 2535 (1992)³ ("Securities Act"), and the regulations and notifications of the Securities and Exchange Commission ("SEC"), the Office of the Securities and Exchange Commission ("Office of the SEC"), and the Stock Exchange of Thailand ("SET"), issued pursuant to the Securities Act.

I. OVERVIEW OF THE REGULATORY ENVIRONMENT IN THAILAND: FINANCIAL SERVICES AND CAPITAL MARKETS

In spite of Thailand's rapidly developing financial markets, the country's legal and regulatory infrastructures, generally speaking, have not been keeping pace with the developments of local and international financial markets.⁴ Traditionally, Thailand has been conservative in adopting untested legal norms and standards. Over the last few years, however, there have been discernable trends towards liberalization and deregulation of certain aspects of the Thai financial and capital markets. As the Thai financial system has undergone unprecedented developments, which were in turn influenced by, among other things, globalization of financial systems and capital markets and the ravaging effects of the financial crisis, the issues of lax supervi-

ties Business and Credit Foncier Business, B.E. 2522 (No. 2), B.E. 2528 (1985) (published in Government Gazette, vol. 102, pt. 177, special vol., Nov. 26, B.E. 2528 (1985)); Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business (No. 2), B.E. 2535 (1992) (published in Government Gazette, vol. 109, pt. 43, Apr. 8, B.E. 2535 (1992)); Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business (No. 3), B.E. 2535 (1992) (published in Government Gazette, vol. 109, pt. 44, Apr. 9, B.E. 2535 (1992)).

2. Commercial Banking Act, B.E. 2505 (1962) (published in Government Gazette, vol. 2, Mar. 28, B.E. 2505 (1962)); Commercial Banking Act (No. 2), B.E. 2522 (1979) (published in Government Gazette, vol. 96, pt. 31, special vol., Mar., 7 B.E. 2522 (1979)); Royal Proclamation Amending Commercial Banking Act, B.E. 2505 (No. 3), B.E. 2540 (1997) (published in Government Gazette, vol. 109, pt. 44, Apr. 9, B.E. 2535 (1997)).

3. Securities and Exchange Act, B.E. 2535 (1992) (published in Government Gazette, vol. 109, pt. 22, Mar 16, B.E. 2535 (1992)).

4. For example, there are currently no derivative laws in Thailand. This does not mean, however, that there have been no derivative transactions in Thailand because non-financial institutions may freely enter into derivative contracts that are not prohibited by generally applicable law unless they are of a speculative nature and, therefore, may be considered wagering or gaming.

sory measures, inadequate regulatory framework, and non-transparency have been brought to the attention of international financial community.

Over the years, the Thailand's Ministry of Finance and the Bank of Thailand ("BOT") have gradually deregulated and liberalized the financial system and financial markets.⁵ The initial phase of deregulation and liberalization emphasized relaxation of interest rate and foreign exchange control law.⁶ In connection therewith, the Thai government, in May 1990, formally announced its acceptance of Article 8 of the International Monetary Fund Agreement, pursuant to which Thailand was obliged to lift restrictions on foreign exchange transactions and refrain from engaging in discriminatory currency arrangements.⁷ Subsequently, most requirements for permission of the exchange control authorities have been abolished and replaced by simple reporting requirements.⁸ As of May 1992, most previous controls on maximum interest and discount rates that banks and

5. For a chronological account of financial reforms in Thailand from 1989 to 1995, see Rungsun Hataiseree, *Monetary Policy in Thailand: Past, Present and Future*, CHULALONGKORN L. REV. 92 (1995).

6. The first major reform occurred in July 1989 when the Bank of Thailand ("BOT") abolished the interest rate ceiling on commercial banks' time deposits with maturity exceeding one year. See Letter from Kamjorn Sathirakul, Governor, Bank of Thailand, to the manager of every commercial bank, Bank of Thailand Circular Letter No. Thor. Por.Tor.Nor.Wor.(Wor) 1043/2532 Re: Payment of Interest on Deposits and Giving of Gifts by Commercial Banks (July 6, 1989) (on file with the *Fordham International Law Journal*).

7. The foreign exchange liberalization commenced with the official acceptance of obligations under Article VIII of the Articles of Agreement of the International Monetary Fund ("IMF") on May 21, 1990. Such acceptance enabled the Bank of Thailand to issue a notification relaxing the foreign exchange regime. See Bank of Thailand Notification No. 50 (May 22, 1990) (on file with the *Fordham International Law Journal*). See generally Sakda Thanitkul, *Obligations under Article 8 of the IMF Agreement and the Reform of Thai Financial System*, VARASAN KOTMAI (JOURNAL OF LAW), vol. 13 (Mar. 2, 1990) (in Thai).

8. Thus, the inward remittance of money into Thailand for investment in securities does not require registration with the exchange control authorities. Foreign currency brought into Thailand, however, must be sold to an authorized agent within 15 days or deposited into a foreign currency account opened with a commercial bank, and a specified form must be submitted to the BOT if the amount deposited exceeds US\$5,000 or its equivalent. The outward remittance from Thailand of interest and principal after payment of the applicable Thai tax, if any, may be made without exchange control permission if the amount does not exceed US\$5,000 or the equivalent in the relevant currency. A specified form must be submitted to the relevant authorized agent together with documents or evidence as to the particular transaction.

finance companies could charge and pay were abolished and replaced by notification requirements.

These and other significant programs aiming at deregulating and liberalizing the Thai financial services sector will be discussed in detail. Many of these regulatory changes, however, were designed not as a breakthrough but were intended as a means to assimilate Thailand gradually to the norms of the international financial community and accede to the obligations under the General Agreement on Trade in Services ("GATS") by which Thailand is obliged to fully liberalize its services sector by the year 1999. Notwithstanding the efforts made by the Thai Government, however, the deregulation and liberalization programs have failed to address the linchpin of the liberalization programs, that is, the issue of foreign shareholding in and ownership of Thai financial institutions and financial services companies as well as an unimpeded and equal access to the Thai financial markets by foreign financial institutions and foreign investors. As it turned out, it would take the Asian financial crisis (of which many consider Thailand to be the regional epicenter) to jar Thailand from its semi-protectionist stance and propel it towards a fully deregulated and liberalized financial market. Ironically, the Thai Government has very little choice but to accept the reality of foreign ownership in Thai financial institutions.

At this point, however, it might be useful to give a thumbnail sketch of the existing regulatory framework of financial services sector, i.e., the scope of permissible businesses for commercial banks, finance companies, and securities companies. The following table summarizes certain of the activities that licensed commercial banks, finance companies, and securities companies are permitted to undertake in Thailand:

Activity	Finance Company	Commercial Bank	Securities Company
Borrowing	Yes	Yes	Yes (1)
Lending	Yes	Yes	Yes (2)
Leasing/Hire Purchase	Yes	No	No
Investment	Yes	Yes	Yes
Foreign Exchange Dealing	Yes (3)	Yes	No
International Trade Financing	No	Yes	No
Underwriting/Selling Agency/Sale Support Agency			
- Equity	Yes (4)	No	Yes
- Debt	Yes (3)	Yes	Yes
Brokerage	No	No (9)	Yes
Securities Registrar	Yes (6)	Yes	Yes (6) (7)
Fund Management			
- Mutual Fund	No	No	Yes (5)
- Private Fund (5) (3)	Yes	Yes	Yes
- Provident Fund (3)	Yes	Yes	Yes
- Open-Ended/Close-Ended Fund	Yes (8)	Yes (8)	Yes (8)
Securitization	Yes	Yes (10)	Yes

(1) Only from financial institutions.

(2) Only margin lending.

(3) Only with permission, on a case-by-case basis, from the Ministry of Finance.

(4) Only sale support agency.

(5) Only with permission, on a case-by-case basis, from the Ministry of Finance with the recommendation of the Securities and Exchange Commission.

(6) Only with permission, on a case-by-case basis, from the Securities and Exchange Commission.

(7) Except for securities companies with mutual fund management license.

(8) Commercial banks, finance companies, securities companies, and insurance companies are permitted to engage in a fund manager business pursuant to the Ministry of Finance's notification. Commercial banks, finance companies, and securities companies are permitted to engage in a fund supervisor business and a sale support agency business.

(9) Commercial banks, as from January 1, 1998, are permitted to act as an agent but only with respect to close-ended investment units provided that it must be appointed by a licensed securities company.

(10) Pursuant to Bank of Thailand's notification dated November 28, 1997.

II. *REGULATION OF THE FINANCE INDUSTRY*

The finance companies in Thailand began to emerge during the 1970s when the Thai economy began to experience a double-digit growth and demand for funding was, thus, increasing dramatically. The first law governing finance companies, referred to as the National Executive Council Announcement No. 58 ("NEC No. 58"), was enacted in 1972.⁹ Article 5 of the NEC No. 58 required companies to secure permission from the Ministry of Finance in Thailand in order to engage in either the fi-

9. Announcement of the National Executive Council No. 58 (Jan. 26, B.E. 2515 (1972)) (published in Government Gazette, vol. 89, pt. 15, special vol., Jan. 27, 1972).

nance or the securities business.¹⁰ Following the passage of NEC No. 58, a total of 104 new licenses were granted (twenty-one finance licenses, seventy-one finance and securities licenses, and twelve securities licenses). In 1977, the Ministry of Finance ceased granting new licenses as the number issued was considered sufficient. Prior to the suspension of the troubled finance companies in 1997, there were altogether ninety-one finance companies and finance and securities companies,¹¹ some of which were affiliated with local commercial banks.

A. *The Finance Industry: Regulatory Framework*

1. Current Finance Industry Regulation

The finance industry in Thailand is currently governed by the FSCA and notifications issued thereunder. Under the FSCA, a company may be granted licenses to engage in four types of finance business: commercial finance, development finance, consumer finance, and finance relating to real estate.¹² In addition, other types of finance business may be permitted on a case-by-case basis.¹³ The BOT may permit a company that is licensed to conduct commercial finance business to give guarantees,¹⁴ and the FSCA permits a company that is licensed to conduct development finance to act as an arranger or broker of financing and as a financial advisor.¹⁵

The FSCA provides that a finance company may not engage in any business other than those businesses authorized by the FSCA except with authorization of the Minister of Finance.¹⁶ As indicated in the table above, subsequent changes in the laws relating to finance companies and developments within the capital markets in Thailand have resulted in the expansion of the scope of finance business to include:

- custodian services for securities, certificates of deposits, and debt securities;¹⁷

10. *Id.* at 3.

11. Source: Bank of Thailand

12. FSCA, *supra* note 1, §§ 8-9.

13. *Id.*

14. *Id.* § 20(6).

15. *Id.*

16. *Id.*

17. Bank of Thailand Circular Letter No. Thor.Por.Tor.Wgor.Por.(Wor) 1834/

- securities registrar;¹⁸
- establishment of a representative office abroad;¹⁹
- business relating to arranging, underwriting, and trading of debt securities;²⁰
- selling agent for government bonds and debt securities issued by government agencies or state-owned enterprises;²¹
- listing sponsor;²²
- property leasing;²³
- repurchase of government bonds or bonds issued by state owned enterprises;²⁴
- provident fund management;²⁵
- financial advisory service relating to issuance of securities;²⁶
- private fund management and supervisory service;²⁷
- loan servicing agent;²⁸

2535 Re: Additional Scope of Businesses for Finance Companies (Oct. 20, 1992) (in Thai) (on file with the *Fordham International Law Journal*).

18. *Id.*

19. Ministry of Finance Notification Re: Bases and Procedures Respecting Application for Permission to Establish Representative Office Abroad and Conditions Thereof (Aug. 1, 1994) (published in Government Gazette, vol. 111, pt. 33 Ngor., special vol., Aug. 10, 1994).

20. Ministry of Finance Notification Re: Conditions of Granting Permission to Finance Company to Operate Business of Issuance, Distribution and Trading of Instruments of Debt (Oct. 6, 1992) (published in Government Gazette, vol. 109, pt. 134, Oct. 15, 1992).

21. Bank of Thailand Circular Letter No. Thor.Por.Tor.Wgor.Por.(Wor) 566/2535 Re: Additional Scope of Businesses for Finance Companies (Mar. 24, 1992) (in Thai) (on file with the *Fordham International Law Journal*).

22. *Id.*

23. Ministry of Finance Notification Re: Conditions in Granting Permission to Finance Company to Operate Business of Property Leasing (No. 2) (June 30, 1994) (published in Government Gazette, vol. 111, pt. 26 Ngor., special vol., July 7, 1994).

24. Bank of Thailand Regulations Governing Trading of Bonds with Financial Institutions with Agreement That Seller Will Repurchase Same, B.E. 2539 (Jan. 17, 1996) (repealing previous regulations) (on file with the *Fordham International Law Journal*).

25. Letter from Rernghai Marakanon, Governor, Bank of Thailand, to the managers of every commercial bank and every financial company, Bank of Thailand Circular Letter No. Thor.Por.Tor.Ngor.Kor.(Wor) 2230/2535 Re: Application for Permission to Operate Business of Management of Provident Fund (Oct. 16, 1995) (on file with the *Fordham International Law Journal*).

26. *See supra* note 20.

27. Ministry of Finance Notification Re: Bases Respecting Granting Permission to Finance Company to Operate Private Fund Management Business (Aug. 2, 1996) (published in Government Gazette, vol. 113, pt. 68 Ngor., Aug. 22, 1996).

28. SEC Notification Re: Rules, Conditions and Procedures With Respect to Supporting Selling Agent for Open-Ended Mutual Fund, B.E. 2536 (July 30, 1993) (on file with the *Fordham International Law Journal*).

- securitization project management;²⁹
- branch opening;³⁰
- credit facility office;³¹
- loan servicing agent;³²
- foreign exchange dealing;³³
- loan collection agent;³⁴
- suretyship.³⁵

2. Statutory Financial Ratio Requirements for Finance Companies

Pursuant to the FSCA and regulations promulgated thereunder, finance companies must maintain the following ratios unless permission is obtained from the BOT.

a. Liquidity

A notification of the BOT dated September 8, 1997, issued under Section 28 of the FSCA,³⁶ replaced the previous notifications regarding liquidity requirements and established a new li-

29. Ministry of Finance Notification Re: Granting General Permission to Allow Finance Company, Finance and Securities Company and Credit Foncier Company to Operate Business of Management of Securitization Project for Forwarding Same to SEC Office, and to Operate Loan Servicing Agent Business (June 30, 1997) (published in Government Gazette, vol. 114, pt. 106 Ngor., Nov. 13, 1997).

30. Ministry of Finance Notification Re: Bases and Procedure Respecting Application for Permission to Set Up Branch Office (Aug. 10, 1987) (published in Government Gazette, vol. 104, pt. 154, Aug. 11, 1987).

31. Ministry of Finance Notification Re: Bases and Procedure Respecting in Applying for Permission to Set Up Credit Facility Office and Condition Thereto, (No. 2) B.E. 2539 (July 4, 1996) (published in Government Gazette, vol. 113, pt. 61 Ngor., July 30, 1996).

32. Ministry of Finance Notification Re: Permission to Allow Finance Company to Operate Loan Servicing Agent Business (June 30, 1997) (published in Government Gazette, vol. 114, pt. 59 Ngor., July 8, 1997).

33. Ministry of Finance Notification Re: Conditions Respecting Permission to Allow Finance Company to Operate Business Concerning Foreign Means of Payment (Apr. 19, 1996) (published in Government Gazette, vol. 113, pt. 34 Ngor., Apr. 25, 1996).

34. Ministry of Finance Notification Re: Permission to Allow Finance Company to Operate Loan Servicing Agent Business (June 30, 1997) (published in Government Gazette, vol. 114, pt. 59 Ngor., July 8, 1997).

35. Bank of Thailand Notification Re: Bases, Procedures and Conditions Respecting Operation of Suretyship Business of Finance Company (Dec. 24, 1993) (published in Government Gazette, vol. 110, pt. 225, special vol., Dec. 28, 1993).

36. Bank of Thailand Notification Re: Maintenance of Liquid Assets of Finance Companies (Sept. 8, 1997) (published in Government Gazette, vol. 114, pt. 78, Sept. 8, 1997) [hereinafter Finance Liquid Assets Notification] (in Thai).

quidity requirement for finance companies and finance and securities companies. As from September 12, 1997, a finance company's liquid reserves, i.e., liquid assets in relation to its total borrowings, shall meet the following requirements:

- liquid reserves shall not be less than 6% of total borrowing (including borrowing from the public);
- at least 0.5 % of the liquid reserves shall be deposited with the BOT;
- at least 4.5% of the liquid reserves shall be in treasury bills, government bonds, debt instruments guaranteed by the Ministry of Finance, debt instruments issued by the Financial Institutions Development Fund³⁷ ("FIDF"), debt instruments or debentures guaranteed (as to principal and interest) by the FIDF, and/or debentures or bonds issued by certain state-owned enterprises, government agencies, or the Industrial Finance Corporation of Thailand; and
- the remaining reserves shall be deposited with commercial banks established in Thailand, lending to commercial banks established in Thailand and/or certificate of deposit issued by a commercial bank.

In addition, at least 6% of the borrowing from abroad that is a demand loan or due or redeemable within a year from the borrowing or drawdown date shall be maintained as a deposit with the BOT as liquidity reserves, except otherwise approved by

37. At this time, no formal deposit insurance scheme exists in Thailand. The Financial Institutions Development Fund ("FIDF"), which is managed by the BOT, collects annual contributions from all financial institutions under the supervision of the BOT at the ratio of 0.1% of deposits. Under certain circumstances, the FIDF may borrow from the BOT when necessary. The FIDF may lend money, take equity interests in certain financial institutions, or bail out troubled financial institutions by purchasing their non-performing assets when the FIDF deems appropriate. The Fund Management Committee consists of high-ranking officials from the Ministry of Finance, the BOT, the Juridical Council, and certain other public entities. See Release of the Bank of Thailand in the Bank of Thailand website (www.bot.or.th). Notwithstanding the fact that there is no formal deposit insurance scheme in Thailand, on August 8, 1997, the BOT issued a regulation providing that the FIDF will insure repayments and payments of principals and interests to depositors and creditors of financial institutions in financial distress except those of any depositor or creditor not acting in good faith or in a normal course of business or any holder of debentures or convertible debentures of less preferential rights than those of ordinary creditors. The FIDF insurance applies to both domestic and foreign creditors. See Regulation of Financial Institution Development Fund (FIDF) Concerning Insurance for Depositors and Creditors of Financial Institutions, B.E. 2540 (Aug. 8, 1997) (on file with the *Fordham International Law Journal*).

the BOT.³⁸

In calculating the foregoing liquidity ratios, a finance company shall use a daily figure of its liquid assets and total borrowing from the public calculated on a weekly basis.³⁹ It is notable that the revised liquid assets now specifically include loans and/or guarantees made by the FIDF.⁴⁰ This is due to a greater reliance on the FIDF by finance companies as a source of funds; over the past few years, in particular, 1997, the FIDF has lent heavily to cash-strapped finance companies. The FIDF (at least prior to the recent financial shakeup of December 8, 1997) was in fact the largest creditor of some of these finance companies.⁴¹

To address the concern of the general public regarding the stability of financial institutions whose operations have not been suspended, on August 7, 1997, the BOT issued a circular letter⁴² requiring that a fund be set aside to support the liquidity of financial institutions.

b. Capital Adequacy

A notification of the BOT dated August 29, 1996⁴³ issued pursuant to Section 29 of the FSCA (replacing the previous notifications on capital adequacy) prescribes that the following capital adequacy ratios shall apply. As from September 17, 1996, a finance company shall maintain its (capital reserve) ratio of all capital to assets and off-balance sheet contingencies at not less than 7%, and the ratio of first tier capital to assets and contingencies shall not be less than 5%. From January 1, 1997, the ratio of all capital to assets and contingencies shall not be less than 7.5%, and the ratio of the first tier capital to assets and contingencies shall not be less than 5%. From January 1, 1998,

38. Finance Liquid Assets Notification, *supra* note 36, ¶ 2.

39. *Id.* ¶ 3.

40. *Id.* ¶ 2(2)(2.2)(c).

41. Through the end of June 1996, the FIDF had extended loans totaling approximately Baht 500 billion – equal to 806% of the gross national product – to 66 finance companies and two commercial banks. (Source: IMF Report).

42. Letter from Jarung Noo-kwan, Deputy Governor, Bank of Thailand, to the manager of every commercial bank, every finance company, finance and securities company, and credit foncier company, Bank of Thailand Circular Letter No. Thor.Por.Tor.Ngor.Por.(Wor) 2404/2540 Re: Setting Aside Liquidity Fund for Financial Institutions (Aug. 7, 1997) (on file with the *Fordham International Law Journal*).

43. Bank of Thailand Notification Re: Capital Adequacy Requirements for Finance Companies (Aug. 29, 1996) (published in Government Gazette, vol. 113, pt. 71 Ngor., Sept. 3, 1996) (in Thai).

the ratio of all capital to assets and contingencies shall not be less than 8.0%, and the ratio of first tier capital to assets and contingencies shall not be less than 5.5%.

Risk assets are weighted according to BOT regulations that generally conform to Bank for International Settlement ("BIS") Guidelines for Capital Adequacy. First tier capital consists of the following: paid-in share capital, including premium paid on issue of shares, the issue price of warrants on shares, and perpetual non-cumulative preference shares; legal reserves and other reserves appropriated from net profit; and retained earnings.⁴⁴

The components of the second tier capital allowed by the BOT are as follows: up to seventy percent of the amount of land revaluation surplus; fifty percent of the amount of building revaluation surplus; and the proceeds from the issuance of long term subordinated bonds or debts, i.e., proceeds having a maturity of more than five years to the extent that such proceeds do not exceed the amount of first tier capital.⁴⁵

c. Lending Limits

A notification of the BOT dated December 24, 1993, as amended⁴⁶ issued by virtue of Section 35 and Section 36 of the FSCA provides that, except with the approval of the BOT, no finance company may lend money to or invest in any person or group of related persons (as defined in the FSCA and regulations thereunder) in excess of any amount equal to twenty-five percent of its first tier capital at the end of each day, or undertake contingent liabilities (such as aval or guarantee) in respect of the obligations of any person or group of related persons in excess twenty-five percent of the first tier capital at the end of each day. The aggregate of such loans, investments, and contingent liabilities with respect to any one person or group of related persons shall not exceed thirty-five percent of first tier capital.⁴⁷

44. Bank of Thailand Circular Letter No. Thor.Por.Thor.Ngor.Por.(Wor) 10/2537 (Jan. 5, 1994) (in Thai) (on file with the *Fordham International Law Journal*).

45. *See id.*; Bank of Thailand Notification Re: Instruments Counted as Capital (Dec. 24, 1993) (on file with the *Fordham International Law Journal*).

46. Bank of Thailand Notification Re: Fixing Ratio of Borrowing or Investment or Obligations or Payment under Obligations for Any One Person to Capital Fund of Finance Company (Dec. 24, 1993) (published in Government Gazette, vol. 110, pt. 225, special vol., Dec. 28, 1993).

47. *Id.* ¶ 3(3).

d. Investments

The FSCA provides that no finance company may purchase or hold shares of any limited company in an amount exceeding ten percent of the total issued shares of such company unless such purchase or holding is approved by the BOT, or, subject to certain exceptions, hold any shares in another finance company unless such purchase or holding is approved by the Ministry of Finance on the recommendation of the BOT.⁴⁸ Some finance companies in the past have tried to circumvent the ten percent shareholding limit by using nominees or agents to hold shares on their behalf directly or impliedly or by holding shares as an undisclosed principal. To curb this practice, on December 14, 1995, the BOT issued a circular letter⁴⁹ ordering the finance companies to seek prior approval from the BOT with respect to any nominee shareholding or the like.⁵⁰

48. FSCA, *supra* note 1, § 20(4).

49. Letter from Charung Nookwan, acting on behalf of the Governor of the Bank of Thailand, to managers of all finance companies and finance and securities companies, Bank of Thailand Circular Letter No. BOT Ngor.For.(Wor) 2693/2538 Re: Purchase or Holding Shares in Other Companies in Excess of the Limit Provided by Law by Having Other Persons Hold Shares as a Nominee (Dec. 14, 1995) [hereinafter Circular Letter 2693/2538] (on file with the *Fordham International Law Journal*).

50. Pursuant to the Circular Letter No. BOT. Ngor.For(Wor) 2693/2538, shareholding in a limited company in the following manners shall be presumed as holding of shares on behalf of the finance company:

1. A limited company established by a person who has a substantial interest in such finance company, or the executives of the limited company are also the executives of the finance company, or the persons who hold shares in such limited company in aggregate more than 10% of the total shares sold of such limited company hold shares in the finance company in aggregate more than 10% of the total shares sold of the finance company.

2. A limited company in which a finance company or executives of the finance company or the persons who hold shares in the finance company more than 5% of the total shares sold of such finance company holds shares in aggregate more than 10% of the total shares sold of such limited company.

3. A limited company in which a finance company or executives of a finance company or the persons who hold shares in the finance company more than 5% of the total shares sold of such finance company or a limited company in 2 above holds shares in aggregate more than 10% of the total shares sold of such limited company.

4. A limited company in which the limited company in 1 or 2 or 3 above holds shares in aggregate more than 10% of the total shares sold of such limited company.

A limited company which was established by a person who has been authorized by the finance company or the executive or shareholders of the finance company.

A limited company in which the employees of the finance company hold

e. Interest Rates

Under the FSCA, the BOT has power to impose limits on the rate of interest or discount that a finance company may pay in relation to borrowing or receiving money from the public or on the rate of interest or discount that a finance company may charge on its lending. In this connection, the BOT subsequently prescribed the following interest rates: the rate of interest or discount payable by the finance company for demand loans shall not be higher than the averaged interest rate for a three-month deposit set by the five major commercial banks;⁵¹ the rate of interest or discount payable by the finance company for term loans shall not be higher than the average interest rate for deposit of the same term set by the five major commercial banks plus three percent per annum; and the rate of interest for loans with less than one-month term shall be zero.⁵²

Shortly thereafter, however, the BOT, recognizing the difficult position of finance companies in the high interest rate environment, issued yet another notification⁵³ granting temporary relief to finance companies: the rate of interest for a short-term loan that is due and payable in less than seven days shall be five percent per annum. This temporary policy will be in effect until the market volatility has improved. Finally, the BOT issued a guideline in respect to the finance companies' practice regarding interest rate on issues such as interest rate on promissory notes used as security for lending, aval of promissory notes, and term of promissory notes.⁵⁴

shares on behalf of the finance company or executives or shareholders of the finance company.

Id.

51. The five referenced Thai commercial banks are: Bangkok Bank, Siam Commercial Bank, Krung Thai Bank, Thai Farmers Bank, and Bank of Ayudhya.

52. Bank of Thailand Notification (No. 2) Re: The Rate of Interest or Discount Payable or Collectible by Finance Companies (Sept. 18, 1997) (on file with the *Fordham International Law Journal*) (superseding Bank of Thailand Circular Letter No. Thor.Por.Thor.Ngor.Wor. (Wor) 2239/2538 (Oct. 17, 1995) (in Thai).

53. Bank of Thailand Notification (No. 3) Re: The Rate of Interest of Discount Payable or Collectible by Finance Companies (Oct. 6, 1997) (published in the Royal Gazette, vol. 114, pt. 91, Oct. 7, 1997) (in Thai) (on file with the *Fordham International Law Journal*).

54. Bank of Thailand Circular Letter No. Thor.Por.Thor. Ngor.(Wor) 3021/2540 Re: Practices Relating to the Interest Rate Payable or Collectible by Finance Companies (Oct. 3, 1997) (in Thai).

f. First Tier Capital to Paid-up Share Capital

Section 26 bis of the FSCA provides that where a finance company's first tier capital is less than three-fourths of the paid-up share capital, the finance company shall be prohibited from borrowing from the public except as otherwise approved by the BOT. Moreover, if a finance company's first tier capital is less than one-half of its paid-up share capital, then the finance company shall immediately cease its operation and submit or project for rectification of its condition and operation to the BOT no later than fourteen days from the date of noncompliance. It should be noted that Section 26 bis has been amended by the Royal Decrees (see below) with respect to reduction or increase of capital fund as a result of a merger or amalgamation.⁵⁵

g. Non-Performing Asset Reserves and Capital Increase (for All Financial Institutions)

On November 12, 1997, the BOT issued the guidelines for compliance and a policy for the revision of bases in respect to realization of income, setting aside of reserves for non-performing assets, and classification of assets.⁵⁶ As of January 1, 1998, all

55. See The Royal Decree Amending Finance, Securities and Credit Foncier Business Act B.E. 2522 (1979) (No. 3), B.E. 2540 (1997) § 3 (published in Government Gazette, vol. 114, pt. 29 Kor., decree issue, June 28, 1997). Section 3 provides that:

The provisions of paragraph five of Section 26 bis of the Finance, Securities and Credit Foncier Business Act B.E. 2522(1979) amended by the Royal Proclamation Amending Finance, Securities and Credit Foncier Business Act B.E. 2522(1979) (No. 2) B.E. 2528(1985) shall be repealed and replaced by the following:

"In case the finance company must reduce or increase capital fund according to the project approved under paragraph two or according to the decision under paragraph three, the provisions of this Act in relation to the fixing of minimum registered capital and paid-up capital of the finance company, and Section 1222, Section 1224, Section 1225 and Section 1226 of the Civil and Commercial Code, and Section 139, Section 140 and Section 141 of the Public Limited Company Act B.E. 2535(1992), as the case may be, shall not apply."

Id.

56. Letter from Chaiwat Wiboonsawad, Governor, Bank of Thailand, to all managers of every commercial bank, every finance company, finance and securities company, and credit foncier company, Bank of Thailand Circular Letter No.Thor.Por.Tor.Ngor. (Wor) 3246/2540 Re: Guidelines for Compliance and Policy of the Authority Respecting Revision of Standards of Financial Institution Supervision (Nov. 12, 1997) (on file with the *Fordham International Law Journal*). The BOT, however, pursuant to its third IMF letter of intent and as a result of the IMF's insistence, has recently indicated that by no later than the end of 1998, the six-month period of non-interest payment with re-

financial institutions (i.e., commercial banks, finance companies, finance and securities companies, and credit foncier companies) are subject to certain requirements.

- They must suspend the recording of accrued interest as income for debtors who have not paid interest for more than six months and to record the amount actually received on a cash basis until the debtors will have paid the principal and interest in full.
- With respect to finance companies, they must set aside reserve for a sub-standard assets in all accounting periods for the six month period at the rate not less than twenty percent (fifteen percent for commercial banks) of the total outstanding amount of sub-standard assets. Moreover, for the assets already classified as sub-standard assets as of June 30, 1997, the financial institution in question shall set aside reserve at the prescribed rate in full no later than the accounting period of 1998. However, in case that any assets have been reclassified as doubtful assets, the financial institution is required to set aside reserve for the entire amount immediately as at the end of the accounting period in which the reclassification occurs.
- All financial institutions are required to prepare a capital increase plan under which capital increase shall be sufficient to cover the setting aside of reserve.

B. Recent Legal and Regulatory Developments

As a consequence of the unprecedented financial turmoil experienced by Thai financial services sector, in particular, the finance industry, new laws were promulgated specifically to deal with the consequences of the crisis. The first series of reform laws⁵⁷ ("Royal Decrees") dated June 27, 1997, included new laws

spect to sub-standard debt will be reduced to three months and both finance companies and commercial banks will be required to set aside 25% reserve for sub-standard assets. See *Pujadkan Raiwan*, *DAILY MANAGER* (in Thai), Mar. 23, 1998, at 14.

57. Royal Decree Amending Commercial Banking Act, B.E. 2505 (1962) (No. 2), B.E. 2540 (1997) (published in Government Gazette, vol. 114, pt. 29 Kor., Decree Issue, June 28, 1997) [hereinafter Bank Royal Decree]; Royal Decree Amending Finance, Securities and Credit Foncier Business Act, B.E. 2522 (1979) (No. 3), B.E. 2540 (1997) (published in Government Gazette, vol. 114, pt. 29 Kor., Decree Issue, June 28, 1997) [hereinafter FSCA Royal Decree]; Royal Decree on Special Purpose Vehicle for Asset Securitization, B.E. 2540 (1997) (published in Government Gazette, vol. 114, pt. 29 Kor., June 28, 1997) [hereinafter Securitization Royal Decree]. Subsequently, the following decree was adopted: Royal Decree Amending Finance, Securities and Credit

on (i) asset securitization, (ii) establishment of a secondary mortgage corporation, (iii) permission to allow foreign shareholdings in a Thai commercial bank to exceed the twenty-five percent limit, and, most importantly, (iv) the amendment of the FSCA. The amendments to the Commercial Banking Act will be discussed separately.

The second series of reform laws, i.e., the Emergency Decrees, became effective on October 25, 1997. The Emergency Decrees were drafted with the following objectives in mind:

- to satisfy the requirement of International Monetary Fund ("IMF") for detailed reform plans in the financial sector;
- to meet the demand of foreign lenders for concrete solutions to the problems relating to foreign currency loans made to Thai corporate borrowers that are likely to default unless the loans are rolled over; and
- to augment the responsibilities of the BOT in order to avoid suspensions or closures of financial institutions in the future.⁵⁸

The following Emergency Decrees were enacted into law:

- Emergency Decree on Financial Sector Restructuring B.E. 2540⁵⁹ ("FRA Decree");
- Emergency Decree on the Asset Management Corporation B.E. 2540⁶⁰ ("AMC Decree");
- Emergency Decree Amending the Bank of Thailand Act B.E. 2485 (No. 2) B.E. 2540⁶¹ ("BOT Decree");
- Emergency Decree Amending the Commercial Banking Act B.E. 2505 (No. 3) B.E. 2540;⁶²

Foncier Business Act, B.E. 2522 (1979) (No. 4), B.E. 2540 (1997) (published in Government Gazette, vol. 114, pt. 60 Kor., Oct. 24, 1997). The term Royal Proclamation is also used to refer to Royal Decrees, but this article will only use the term Royal Decrees.

58. See Pradit Sahachaiyunta & Apisith John Sutham, *Emergency Decrees Aimed at Restructuring the Financial Sector*, CAPITAL ASIA, vol. 8, Issue No. 10, Dec. 10, 1997.

59. Emergency Decree on Financial Sector Restructuring, B.E. 2540 (1997) (published in Government Gazette, vol. 114, pt. 60 Kor., Oct. 24, 1997) [hereinafter FRA Decree].

60. Emergency Decree on the Asset Management Corporation, B.E. 2540 (1997) (published in Government Gazette, vol. 114, pt. 60 Kor., Oct. 24, 1997) [hereinafter AMC Decree].

61. Emergency Decree Amending the Bank of Thailand Act, B.E. 2485 (No. 2), B.E. 2540 (1997) (published in Government Gazette, vol. 114, pt. 60 Kor., Oct. 24, 1997).

62. Emergency Decree Amending Commercial Banking Act, B.E. 2505 (No. 3), B.E. 2540 (1997) (published in Government Gazette, Vol. 114, Pt. 60 Kor., Oct. 24, 1997) [hereinafter Commercial Bank Decree].

- Emergency Decree Amending the FSCA (No. 4) B.E. 2540⁶³ (“FSCA Decree”); and
- Emergency Decree Amending the Revenue Code (No. 17) B.E. 2540.⁶⁴

1. The Royal Decrees

Even though the regulatory framework for the finance industry remains largely unaltered, certain changes have been introduced to the legal framework, including those relating to the oversight responsibilities by the BOT, by way of the Royal Decrees and the Emergency Decrees, both of which amended the FSCA in several important respects.

The Royal Decrees supplement the existing powers of the Ministry of Finance and the BOT in a number of ways. Arguably the most important changes made to the FSCA relate to amendments of the FSCA and various other laws made in order to expedite merger or transfer of the business of insolvent finance companies (i.e., the fifty-eight finance companies suspended by the BOT) to the more financially sound financial institutions.

a. Amendments in Relation to Reductions and Increases of Capital in a Finance Company

This Royal Decree waives the requirements in the Public Limited Companies Act B.E. 2535⁶⁵ (“PLCA”) whereby the capital requirements shall not apply to changes in capital of a finance company. As a result, changes in capital of a finance company are now exempted from the following requirements: capital shall not be reduced each time to below twenty-five percent of then registered capital; and notice must be given to creditors who have either six months (in case of a private limited company) or two months (in case of a public limited company) to object to reduction in capital and if the objecting creditor is not

63. Emergency Decree Amending the Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business, B.E. 2522 (No. 4), B.E. 2540 (1997) (published in Government Gazette, vol. 114, pt. 60 Kor., Oct. 24, 1997) [hereinafter FSCA Decree].

64. Emergency Decree Amending Revenue Code (No. 17), B.E. 2540 (1997) (published in Government Gazette, vol. 114, pt. 60 Kor., Oct. 24, 1997).

65. Public Limited Company Act, B.E. 2535 (1992) (published in Government Gazette, vol. 109, pt. 43, Apr. 4, B.E. 2535 (1992)) [hereinafter PLCA].

paid or given security for his debt, then the capital reduction cannot proceed.

b. Amendments in Relation to Merger and Transfer of Business

The key amendments relating to the merger and transfer of the business of finance companies include the following:

- mergers of finance companies will not result in an automatic transfer of licenses (including a securities license held by a finance and securities company) held by the merged companies to the new company;
- exemption from Section 306 of the Civil and Commercial Code⁶⁶ relating to a requirement for notice or consent of the obligors in case of a transfer of claims by assignment;
- waiver (with consent of the BOT) from the FSCA's prohibition on individuals from holding directorships or management positions in more than one finance company in case a finance company acquires shares in another; and
- during the merger or transfer of the asset process, no creditors may initiate bankruptcy proceedings against the companies involved in the process.

Moreover, finance companies involved in an approved merger or asset transfer are exempted from, among others, the following:

- the normal restrictions of company law on issuing new shares at a discount to par value;
- the normal requirement prohibiting interested parties from voting at a shareholder meeting;⁶⁷ and
- Section 114 of the Bankruptcy Act⁶⁸ (which provides that a court may cancel any transfer of assets within three years prior to a bankruptcy application unless the transferee can prove good faith and payment in due consideration).

2. The Emergency Decrees

Broadly speaking, the Emergency Decrees ("Decrees") aug-

66. The Civil and Commercial Code of Thailand § 306 as amended (specifying that transfer of obligation performable to specific creditor is not valid unless it is made in writing and it can be set up against debtor or third person only if notice has been given to debtor or debtor has consented to transfer).

67. The Civil and Commercial Code of Thailand § 1185.

68. Bankruptcy Act, B.E. 2483 (1942) § 114.

ment the regulatory power and supervisory authority of the BOT in relation to (the remaining) finance companies and finance and securities companies. While it is true that in the past the BOT was able to interfere with the management affairs of finance companies to a certain degree, the Decrees expressly provide that the BOT is empowered, among others things, to order a finance company to increase its capital without approval from the shareholders (as required by the Civil and Commercial Code or the PLCA) and to order allocation of share increases notwithstanding the rights of existing shareholders to have first priority in the subscription of such shares.⁶⁹

a. FRA Decree

During the restructuring of finance companies and while the suspended finance companies are under the supervision of the FRA, the powers of the BOT and the Ministry of Finance relating to the restructuring will be transferred to the FRA, which will then have comprehensive powers;

- in case that any suspended finance company is permitted to resume its operations as normal, such finance company will be brought under the BOT's supervision;⁷⁰
- the FRA will sell assets of finance companies that cannot be rehabilitated through public auction (and, in the process, issue guidelines to depositors and creditors of suspended finance companies);⁷¹ and
- the board of directors of FRA is vested with the power to grant waivers from the FSCA in respect to legal shareholding limits and foreign shareholding limits.⁷²

69. See FRA Decree, *supra* note 59, § 25 (proclaiming that to rehabilitate suspended finance companies, Financial Sector Restructuring Authority ("FRA") is empowered to order such companies to write down or increase capital); PLCA, *supra* note 65, §§ 136, 139 (requiring shareholders resolution by not less than three-quarters of total number of votes of shareholders attending meeting and entitled to vote shall be waived.)

70. On December 15, 1997, the FRA and the BOT announced that out of 56 suspended finance companies, only Kiatnakin Finance Public Company Limited and Bangkok Investment Public Company Limited would be permitted to resume operations as normal.

71. See FRA Decree, *supra* note 59, § 16 (empowering FRA to issue procedures for liquidation and sale of assets of unviable suspended finance companies).

72. See *id.* § 23 (vesting power to grant permission, waivers, or approvals under FSCA for certain specified matters in FRA).

b. Asset Management Corporation Decree

The aim of the Asset Management Corporation (“AMC”) is primarily to acquire the bad or impaired assets of the suspended finance companies as well as to acquire certain good assets.⁷³ To carry out this mission, the AMC Decree empowers the AMC to issue rules concerning the valuation appraisal of the assets and collateral to be purchased by the AMC.⁷⁴

c. Emergency Decree Amending the Bank of Thailand Act

The BOT Decree empowers the FIDF to require financial institutions to contribute based on the amount of liabilities guaranteed by the FIDF and to procure government financial support for the FIDF or rendering financial assistance to depositors and creditors of financial institutions.⁷⁵

d. Emergency Decree Amending the FSCA

As mentioned earlier, the FSCA Decree empowers the BOT to order a finance company to increase its capital without approval from the shareholders, as required by the Civil and Commercial Code or the PLCA, as the case may be. In addition, where there is an urgent need to rectify the condition and operation of a finance company, the BOT – with the approval of the Minister of Finance – has the power to remove directors or executives of such finance company and to appoint any replacement person immediately.⁷⁶

e. Emergency Decree Amending the Commercial Banking Act

This decree bears a similar purpose and principles as the decree amending the FSCA.

3. The “Super Finance” Company Law

In order to prepare financial institutions to face stronger competition and to promote their long-term stability, on April 3,

73. See AMC Decree, *supra* note 60, § 7(1)-(2) (explaining that purposes of Asset Management Corporation (“AMC”) are “to administer the business of purchasing or receiving transfer of impaired assets” of any financial institutions and “to manage the purchased assets and subsequently sell them off.”).

74. See *id.* § 17(4) (empowering AMC to issue rules concerning valuation appraisal of assets and collateral).

75. See BOT Decree, *supra* note 61, § 29 quinqué.

76. See FSCA Decree, *supra* note 63, § 3 (amending Section 57 bis of FSCA).

1997, the BOT, with the Ministry of Finance's approval, issued a circular letter to financial institutions advising them of the new rules regarding the conglomeration of the businesses of financial institutions.⁷⁷ First, as of April 3, 1997, any finance company, finance and securities company, or credit foncier company contemplating their businesses together may submit a conglomeration plan to create a "super finance" company to the BOT. Second, any commercial bank that intends to have any finance company, finance and securities company, and credit foncier company, may also submit a conglomeration plan to the BOT.

Subsequently, the Ministry of Finance issued a notification⁷⁸ supplementing the circular letter and set the bases for qualification.

- *"Super finance" company*: in case of conglomeration of businesses to expand the category of businesses (i.e., to become a "super finance" company), there must be a core finance company, finance and securities company, or a group of finance companies or finance and securities companies, of not more than three companies whose net first tier capital in the aggregate is not less than 3,000 million baht and whose net assets in the aggregate are not less than 30,000 million baht. The conglomerated or merged finance company shall have net assets not less than 40,000 million baht and net first tier Capital not less than 4,000 million baht.
- *New commercial bank*: in case of conglomeration of businesses for the purpose of applying for a license to operate commercial banking business, there must be a core finance company, finance and securities company, or a group of finance companies or finance and securities companies of not more than three companies whose net first tier capital in the aggregate is not less than 7,500 million baht and whose net assets in the aggregate are not less than 75,000 million baht; provided, however, that the conglomerated financial institutions apply-

77. Letter from Rergchai Marakanond, Governor, Bank of Thailand, to all managers of every commercial bank, every finance company, finance and securities company and credit foncier company, Bank of Thailand Circular Letter No. Thor.Por.Tor.Ngor.Por.(Wor) 953/2540 Re: Conglomeration of Business of Financial Institutions (Apr. 3, 1997) [hereinafter Super Finance Circular Letter] (on file with the *Fordham International Law Journal*).

78. Ministry of Finance Notification Re: Permission to Operate Additional Business and to Set Up Branch Office (June 10, 1997) (published in Government Gazette, vol. 114, pt. 49 Ngor., June 24, 1997).

ing for a new banking license have the net first tier capital in the aggregate of not less than 15,000 million baht and whose total net assets are not less than 150,000 million baht.⁷⁹

In addition, the BOT and/or the relevant authority would waive certain conditions applicable to the conglomerated financial institution including a relaxation of the statutory shareholding limits in financial institutions.⁸⁰ Moreover, the "super finance" company would be required to separate the accounts of securities business from that of finance business, and the separation must be completed within five years.⁸¹ Finally, the circular letter provides that the financial institution that has conglomerated with, among others, a foreign financial institution, may apply for a waiver of applicable foreign shareholding limit and a limit on the number of foreign directors in a Thai financial institution.⁸² At this time, there have been only a few reported cases of a financial institution applying to become a "super finance" company.⁸³

III. REGULATION OF THE BANKING INDUSTRY

Established in 1942 as the central bank by virtue of the Bank of Thailand Act,⁸⁴ the Bank of Thailand is in charge of implementing domestic monetary policy. Historically, the BOT has been closely involved in the regulation of the domestic banking and finance industry in Thailand. Its principal functions are to (i) issue currency on behalf of the government, (ii) act as banker

79. See Super Finance Circular Letter, *supra* note 77, ¶ 4.1(2).

80. Other conditions include: the conglomerated financial institution which is of the size according to the bases may apply for a license to operate commercial banking business by the end of each year; if a financial institution is a listed company or is a member of the SET prior to the conglomeration, the conglomerated financial institution will be allowed to maintain its status as a listed company or a SET member; the conglomerated financial institution is required to surrender all old licenses in order to obtain a new license for the operation of "super finance" business or commercial banking business; and the conglomerated financial institution is required to cooperate with the authority in solving the problems of other financial institutions. See *id.* ¶ 5.

81. This required separation of finance and business accounts with five years may be, however, inconsistent with the BOT's recent announcement that the separation of finance and securities business must be completed by the end of 1999.

82. See Super Finance Circular Letter, *supra* note 77, ¶ 6.

83. For example, Dhana Siam Finance and Securities Public Company Limited is in the process of transforming itself and its subsidiaries into a super finance company. See *Firms to merge after share issue: Dhana Siam on path to super finance Goal*, BANGKOK POST, Mar. 12, 1998.

84. The Bank of Thailand Act, B.E. 2485 (1942) as amended.

to the government, commercial banks and other financial institutions, and (iii) manage public debt, administer exchange controls, supervise commercial banks, finance companies, and credit foncier (mortgage lending) companies, and deal with international monetary organizations.⁸⁵ The BOT is under the authority of the Ministry of Finance and is governed by an eleven member court of directors, consisting of a Governor and two Vice Chairmen appointed by the King on the advice of cabinet and other members approved by the cabinet on the advice of the Minister of Finance.

The BOT and the Ministry of Finance are granted broad powers under the Bank of Thailand Act and the Commercial Banking Act to regulate commercial banking activities.

A. *The Banking Industry: Regulatory Framework*

1. Licensing: Limitation of Business Activities of Banks

Under the Commercial Banking Act, commercial banking activities consist mainly of lending to and taking deposits from the public and corporations.⁸⁶ As previously mentioned, Thai commercial banks are also authorized to conduct, among others, a foreign exchange business and to underwrite debt securities. Thai commercial banks are restricted from engaging in any business that is not incidental to the commercial banking business and are currently not able to engage directly in, for instance, leasing, equity underwriting, or brokerage of securities. Domestic branches of foreign banks can take deposits and use such deposits for lending activities only after having obtained a license from the Ministry of Finance.

Commercial banks are also subject to a number of other restrictions on the operations of their business. In particular, commercial banks may not: (1) reduce their capital without authorization of the Ministry of Finance; (2) grant any credit to or guarantee debts of directors and certain related persons; (3) accept their own shares or shares of another commercial bank as security; (4) hold fixed property except for offices and foreclosed property; (5) hold equity securities of any company in excess of

85. See generally *id.*; The Royal Decree Amending the Bank of Thailand Act, B.E. 2485 (1942), B.E. 2528 (1985) (published in Government Gazette, vol. 102, pt. 177, special vol., Nov. 26, 1985).

86. See Commercial Banking Act, *supra* note 2, § 4.

ten percent without the approval of the BOT; (6) hold shares in other domestic commercial banks (except those acquired as a result of a debt settlement or a guarantee in respect of credit granted, or those permitted by the Minister of Finance); (7) pay money or give property to directors except as salary or other remuneration; (8) sell property to any director in excess of the amount set by the BOT; or (9) commit any act which may cause damage to the economy of the public interest, constitute an unfair advantage of its customers, or create obstacles to the development of orderly competition in financial markets, as prescribed by the BOT.⁸⁷

The BOT is given broad power to regulate a number of other aspects of the operations of commercial banks, such as deposit interest rates, interest rates and fees that may be charged, rules and procedures for accepting deposits or borrowing money, and other matters. Currently, the BOT prohibits commercial banks from paying interest on demand accounts or time deposits with a maturity of less than three months and sets the maximum rate of interest that commercial banks may pay on time deposits with a maturity of more than three months.⁸⁸ The BOT, however, gives banks flexibility to set their own interest rates with respect to demand accounts. The BOT has also set certain rules with respect to certificates of deposit, including the requirement that such deposits be in minimum amount of 500,000 baht and not be issued in aggregate exceeding the amount of a bank's capital.⁸⁹

2. Liquidity

Under the Commercial Banking Act, the BOT can require commercial banks to maintain cash reserves and liquid assets in

87. See generally The Bank of Thailand Act, *supra* note 84; The Commercial Banking Act, *supra* note 2.

88. Bank of Thailand Notification (No. 4) Re: Prescribed Interest Rates and Discount for Commercial Banks (Sept. 18, 1997) (on file with the *Fordham International Law Journal*). Pursuant to this notification, the rate of interest payable by commercial banks on time deposits with a maturity of more than three months may not exceed the averaged interest rate paid by the major commercial banks for time deposits during the same period plus 3% per annum. The major commercial banks are: Bangkok Bank, Thai Farmers Bank, Siam Commercial Bank, Krung Thai Bank, and Bank of Ayudhya.

89. Bank of Thailand Notification Re: Prescription of Certificate of Deposit to be Observed by Commercial Banks (June 25, 1992) (published in Government Gazette, vol. 109, pt. 82, June 25, 1992).

proportion to deposits and/or borrowings at prescribed ratios. Previously, the BOT required commercial banks maintain liquid assets of at least seven percent of domestic deposits based on bi-weekly daily averages and seven percent of short-term liabilities. However, on September 8, 1997, the BOT issued a notification amending the applicable liquidity ratio.⁹⁰ The new rule now requires commercial banks to maintain liquid assets of at least six percent of domestic deposits. The liquid assets must consist of the following items:

- non-interest bearing deposits with the BOT of at least 2.0% of domestic deposits;
- cash, not to exceed 2.5% of domestic deposits; and
- unencumbered securities, such as treasury bills, government bonds and other debt instruments whose principal and interest are guaranteed by the Ministry of Finance, other government agency or government enterprise bonds approved by the BOT, debentures and bonds of the Industrial Finance Corporation of Thailand and other eligible securities as approved by the BOT.⁹¹

In addition, the Ministry of Finance may require commercial banks to maintain a special cash reserve at the BOT for the purpose of maintaining the stability of the Baht.

3. Capital Adequacy

The Commercial Banking Act provides that a commercial bank must maintain its capital funds in proportion to its assets, liabilities, or contingent liabilities in accordance with regulations published by the BOT.⁹² Pursuant to this authority, the BOT by virtue of the notification dated June 5, 1992⁹³ implemented the

90. Bank of Thailand Notification Re: Commercial Banks to Maintain Liquid Assets (Sept. 8, 1997) (published in Government Gazette, vol. 114, pt. 78, Sept. 8, 1997). The notification also amended the applicable liquidity ratio for international banking facilities (i.e., Bangkok International Banking Facilities ("BIBFs") and Provincial International Banking Facilities ("PIBFs")) from 7% to 6%. BIBFs and PIBFs are required to maintain a non-interest bearing deposit as liquid assets with the BOT of at least 6% of total deposits of non-residents and 6% of the total borrowings from abroad that are due or payable within one year from the borrowing date.

91. *Id.*

92. See Commercial Banking Act, *supra* note 2, § 4.

93. Bank of Thailand Notification Re: Prescription on maintaining of capital funds by domestic commercial banks (June 5, 1992) (published in Government Gazette, vol. 109, pt. 74, June 5, 1992).

capital adequacy framework adopted by the Basle Committee. These guidelines initially specified a minimum capital to risk-weighted assets ratio of 6.5% for first tier and second tier capital combined as from January 1, 1993. The capital adequacy ratio will then increase to 6.5% no later than the end of 1994. Risk-weighted assets consist of all the assets on a bank's balance sheet together with certain off-balance sheet items, discounted by certain risk weightings of 0%, 20%, 50%, and 100%, depending on the asset.⁹⁴

Over the years, the BOT has amended the capital adequacy from time to time.⁹⁵ In view of the increasing level of non-performing loans and sub-standard assets carried by Thai commercial banks and their inadequate capital funds in relation to such non-performing loans and other bank assets, on November 20, 1996, the BOT prescribed that Thai commercial banks shall maintain maximum capital to risk-weighted assets ratio of 8.5% of their assets and contingent liabilities.⁹⁶ Moreover, the first tier capital shall not be less than 6% of such assets and contingent liabilities.⁹⁷ It may be interesting to point out that in the third letter of intent submitted by the Government of Thailand to the IMF,⁹⁸ the Thai Government explained that it intended to complete its plan to raise the capital funds and reserve requirements for Thai commercial banks to the international standard

94. *Id.* For example, cash and a deposit with the BOT are assigned risk weighting of 0%; on the other hand, land or building is assigned risk weighting of 100%.

95. *See, e.g.*, Bank of Thailand Notification Re: Prescription on maintaining of capital funds by domestic commercial banks (No. 4) (June 20, 1994) (no longer in force) (on file with the *Fordham International Law Journal*); Bank of Thailand Notification Re: Prescription on maintaining of capital funds by domestic commercial banks (No. 5) (Apr. 25, 1996) (no longer in force) (on file with the *Fordham International Law Journal*); Bank of Thailand Notification Re: Prescription on maintaining of capital funds by domestic commercial banks (No. 6) (Aug. 29, 1996) (no longer in force) (on file with the *Fordham International Law Journal*).

96. *See* Bank of Thailand Notification Re: Prescription on maintaining of capital funds by domestic commercial banks (Nov. 20, 1996), art. 3 (published in *Government Gazette*, vol. 113, pt. 95, Nov. 20, B.E. 2539 (1996)).

97. *Id.*

98. The Letter of Intent from the Government of Thailand to Michel Camdessus of International Monetary Fund (Feb. 1998) (in Thai) (on file with the *Fordham International Law Journal*). The Thai Government has submitted letters of intent to the IMF on two previous occasions. Under the IMF-led rescue plan, Thailand is to receive US\$17.2 billion in total. Of the US\$17.2 billion, Thailand has already received US\$10.310 billion. The remaining US\$6.890 billion is expected to be disbursed later this year after the fourth letter of intent is submitted to the IMF no later than May 1998.

by the year 2000.⁹⁹

With respect to capital funds of branches of foreign banks, the BOT prescribed that branches of foreign banks licensed to operate commercial banking business in Thailand shall maintain a minimum capital to risk-weighted asset ratio of not less than 7.5%, and the assets and contingent liabilities shall not include assets and contingent liabilities of the international banking facility business.¹⁰⁰

4. Investments

The Commercial Banking Act sets forth various restrictions on the ownership of shares in commercial banks. For example, the Commercial Banking Act provides that no person shall hold more than five percent of a commercial bank, except for shares held by government agencies, without the approval of the Ministry of Finance.¹⁰¹ In addition, ownership of a Thai commercial bank by non-Thai nationals is limited to twenty-five percent of such bank's outstanding shares (and no more than twenty-five percent of the directors can be non-Thai nationals).¹⁰² Commercial banks are also prohibited from holding shares in any other commercial bank, except pursuant to settlement of a debt or guarantee; provided that any such shares must be sold within six months of acquisition.¹⁰³ In addition, a commercial bank's total investment in equity securities cannot exceed twenty percent of its first tier and second tier capital combined.¹⁰⁴

Notwithstanding the foreign shareholding limit of twenty-five percent by non-Thai nationals in a commercial bank, the Royal Decrees expressly granted the Ministry of Finance and the

99. *Id.* Annex, ¶ 6 (outlining economic policy of Thai Government). At the time of this writing, the IMF had expressed its intention not to relax the "iron-cladded" loan reserve and loan classification requirements, in spite of the local banks' request. See *Pujadkan Raiwan*, *DAILY MANAGER*, Mar. 23, 1998, at 14.

100. Bank of Thailand Notification Re: Branches of Foreign Banks To Maintain Capital Fund (No. 8) (Nov. 20, 1996) (published in *Government Gazette*, vol. 113, pt. 95, Nov. 26, 1996) (repealing previous notifications).

101. Commercial Banking Act, *supra* note 2, § 5 bis.

102. *Id.* § 5 quinqué.

103. *Id.* § 12(6).

104. Bank of Thailand Circular Letter No. Thor.Por.Thor.Ngor.Gor.(Wor) 950/2537 Re: Notification of Bank of Thailand on Purchase or Holding of Shares in the Aggregate as a Percentage of Capital (May 26, 1994) (on file with the *Fordham International Law Journal*).

BOT the discretion to waive the foreign shareholding limit applicable to commercial banks on a case-by-case basis.

5. Loan Classifications

The Commercial Banking Act gives the BOT broad power to require banks to classify and provide for or to write off non-performing assets. The BOT's regulations (subject to the new BOT's notification on reserve requirements for all financial institutions including commercial banks) require that banks classify their loan portfolios (except for loans to the Thai government) at the end of each quarter, and these classifications are used to determine the minimum levels of loan loss reserves that banks are required to maintain, with such minimum reserves required to be reflected on a bank's balance sheet.¹⁰⁵ Banks are permitted, however, to use more stringent methods for determining loan loss reserves. The regulations establish three different categories corresponding to levels of risk and set out a procedure for the classification of loans: sub-standard, doubtful, and non-collectible.¹⁰⁶

Previously under the BOT's regulations, sub-standard loans require no loan loss reserves. As part of the revised standards for financial institutions, the BOT, however, now requires that commercial banks set aside a sufficient reserve for sub-standard as-

105. See Bank of Thailand Circular Letter No. 1236/2541 Re: Classification of Loans (Mar. 31, 1998) (on file with the *Fordham International Law Journal*).

106. Sub-standard loans are those in which the loan is in arrears, but where reasonable grounds exist to believe that full payment will eventually be made. Expectation of full payment can be based on the presence of sufficient security, the legal enforcement of repayment, and the borrower undergoing restructuring negotiations.

Doubtful loans are those for which repayment is uncertain and the loan is unsecured. In addition, for partly secured loans that would otherwise have been classified as sub-standard, the unsecured portion of loans would be classified as doubtful. Doubtful loans may arise in several circumstances, including existence of a court order against the borrower, cessation or dissolution of the borrower's operations, the undertaking of action by the borrower to prevent collection such as removing or impairing the value of mortgaged property or altering domicile, operation at a loss for three years or more, suit against the borrower by a commercial bank or application for participation in collateral for which other creditors have sought to participate, or failure to comply with negotiated restructuring terms.

Non-collectible loans are those where reasonable action has already been taken for recovery without successful conclusion and where recovery is not expected. Non-collectible loans would result from death or disappearance of the borrower whose obligations are not secured, dissolution of business where the debt ranks junior to other creditors, or lack of property which may be liquidated. Similar rules apply with respect to a commercial bank's equity investments.

sets.¹⁰⁷ Doubtful loans and non-collectible loans, on the other hand, require full provisioning, i.e., one hundred percent of the amount treated as doubtful or non-collectible.¹⁰⁸ The BOT reviews the classification procedures for all commercial banks in Thailand on an annual basis. As part of this review, the BOT reviews particular files on a random basis to determine compliance with applicable regulations and may require banks to classify a particular loan or to change an existing classification.

a. New Bank of Thailand Regulations on Loan Classification, Provisions, Supervision of Interest, and Other Related Requirements

On March 31, 1998, the BOT announced revised guidelines regarding loan loss classification and reserves, interest recognition, and collateral valuations. The new guidelines require banks to categorize their loan portfolios into five categories – two categories for non-classified (or performing loans) and three categories for classified (or non-performing loans) – and to set minimum reserves based on these categories. The guidelines also set new interest accrual and reversal policies and set maximum collateral valuation limits for the purpose of setting reserves.

The new guidelines require that performing loans be categorized as “Pass” or “Special Mention” loans. Pass loans are loans that show no signs of default and are unlikely to cause the bank to sustain any loss. Special Mention loans are those that show no signs of default, but where there are indications of weakness which, if not corrected, could weaken the borrower’s ability to meet interest payments. Loans, however, should not be categorized as Special Mention loans if they are past due more than three months.

Non-performing loans are required to be classified in one of three categories – sub-standard, doubtful, and loss – based on

107. See Letter from Chaiwat Wiboonsawad, Governot, Bank of Thailand, to the manager of every commercial bank, every finance company, finance and securities company, and credit foncier company, Bank of Thailand Circular Letter No. Thor.Por.Tor.Ngor.(Wor) 3246/2540 Re: Guidelines for Compliance and Policy of the Authority Respecting Revision of Standards of Financial Institution Supervision (Nov. 12, 1997) [hereinafter Bank of Thailand Circular Letter No. 3246/2540] (on file with the *Fordham International Law Journal*).

108. *Id.*

the period of time a loan is past due as well as qualitative criteria, such as the prospects of the business of the borrower. Sub-standard loans are those where there is a possibility that the bank will sustain capacity. Any loan that is past due for more than three but not more than six months should be classified as sub-standard. Doubtful loans are those that have deteriorated below sub-standard and where full repayment of the principal and interest is not expected or where the account is past due more than one year. Banks must stop accruing interest on loans that are past due for more than three months and will be required to reverse accrued but unpaid interest after the phase in period.

The new guidelines will require banks to conduct regular qualitative reviews of their loan and off-balance sheet exposures and put in place appropriate risk management systems and controls. During any calendar quarter, banks are required to review at least seventy percent of their loans and off-balance sheet exposures, including the 100 largest exposures and all related party exposures. Certain standardized loans, such as credit card, automobile, and housing loans may be reviewed on a group basis using statistical methods. Also, the guidelines provide that if one loan to a borrower is classified, then all loans to that party should be classified, absent sufficient documentation indicating that such other loans have no payment uncertainties.

Banks must then set prescribed minimum levels of reserves based in the category of classification. Pass loans require a general reserve of one percent and Special Mention loans require a reserve of two percent, regardless of collateral. For classified loans, the amount of the reserve will be determined based on the amount of the loan minus collateral value, with the collateral value calculated in accordance with maximum collateral valuation limits. Generally, the amount of a classified loan covered by collateral will require no additional reserve. The uncovered portion will require progressively higher reserves depending on the category of risk: twenty percent for sub-standard loans, fifty percent for doubtful, and one hundred percent for loss loans. The maximum collateral valuation limits are based on type of collateral and the last valuation. Cash is valued at one hundred percent, while marketable securities are subject to maximum limit of ninety-five percent. Other collateral is subject to maximum limits of ninety percent of appraised value, if valued within the previous six months, or fifty percent of appraised value of prior

to six months. The guidelines also provide that collateral values for large loans, as defined by the BOT, should be based on external appraisals. The BOT has not yet issued guidelines defining such large loans.

The new requirements will become effective in phases. The new classification requirements and valuation requirements will become effective on July 1, 1998, while new reserves will be required to be added on a pro rata basis over five semi-annual periods ending December 31, 2000. In addition, starting January 1, 1999, banks must stop allowing loans due more than three months from accruing interest, and, starting January 1, 2000, must begin reversing accrued but unpaid interest on non-performing loans. Banks are, however, permitted to begin complying with these requirements early. After July 1, 1998, banks are expected to stop permitting loans that are past due more than three months from accruing and reversing interest.

6. Lending Limits

The BOT, by virtue of the Commercial Banking Act,¹⁰⁹ has the authority to prohibit commercial banks from extending credit to, or undertaking contingent liabilities for, any person in excess of the prescribed ratio. Effective as of July 27, 1996, a BOT notification imposes a single person credit limit of twenty-five percent of first tier capital for loans, investment, contingent liabilities, bill discounting, debt underwriting (on the firm basis), currency agreements (such as currency options), and interest rate agreements (such as interest rate options), measured daily for individual exposures.¹¹⁰

7. Corporate Governance

Under the Commercial Banking Act, commercial banks are prohibited from appointing certain persons as directors or officers, including persons who have been declared bankrupt or imprisoned for fraudulent activities, persons who have been dismissed from the government for dishonesty, persons who were

109. Commercial Banking Act, *supra* note 2, §§ 13, 13 bis.

110. Bank of Thailand Notification Re: Fixing Ratio of Amount of Money That Commercial Bank Has Granted Credits to, Invested and Created Contingent Liabilities for Any One Person to Capital Fund (June 26, 1996) (published in Government Gazette, vol. 113, pt. 18 Ngor., special vol., June 26, 1996) (repealing previous notifications).

directors or officers of a commercial bank whose license was withdrawn, persons removed on the recommendation of the Ministry of Finance, and certain government officials.¹¹¹ Directors of commercial banks are also prohibited from serving as directors of, or holding any other positions in, other commercial banks or securities companies if the particular bank is involved in securities underwriting and trading activities.¹¹²

The BOT already has broad power to intervene in commercial bank's affairs.¹¹³ Nevertheless, the Royal Decrees and the Decrees, further expanded the BOT's authority by expressly authorizing it to remove immediately directors, managers, or persons responsible for the operation of the commercial bank and appoint a replacement if there is an urgent need to rectify the financial condition or the operation such that any delay may cause damage to the interests of the public.¹¹⁴

B. Deregulation and Liberalization of the Commercial Banking Sector

1. Pre-Financial Crisis Stage

Over the years, the Ministry of Finance and the BOT have been gradually deregulating and liberalizing the domestic financial and banking sectors. Some examples of significant reforms implemented prior to the outbreak of the financial crisis by the Ministry of Finance and the BOT include:

- removing deposit and lending interest rate ceilings in 1989 and 1992;¹¹⁵
- adopting the minimum retail rate¹¹⁶ ("MRR");

111. Commercial Banking Act, *supra* note 2, § 12 quarter.

112. *Id.* § 19.

113. *See, e.g., id.* § 24 bis.

114. *See* Commercial Bank Decree, *supra* note 62, § 4 (repealing and replacing Section 24 bis). Prior to the amendment, it was not clear whether the Bank of Thailand could remove a bank's director or manager immediately.

115. Bank of Thailand Notification Re: Prescription for Commercial Banks Regarding Interest Rates and Discounts (May 31, 1989) (published in Government Gazette, vol. 106, pt. 87, special vol., May 31, 1989); Bank of Thailand Notification Re: Prescription for Commercial Banks Regarding Interest Rates and Discounts (May 28, 1989) (published in Government Gazette, vol. 109, pt. 70, May 28, 1992) .

116. The minimum retail rate ("MRR") is the rate charged by commercial banks to their small customers with the best credit rating. Other small customers will be charged with the MRR plus a margin. As a commercial bank's MRR is related to its funding costs plus administrative costs, if the bank's deposit cost declines, then the MRR will also decline. This tends to result in greater competition among local banks.

- adopting the Basle Committee framework;¹¹⁷
- permitting commercial banks to provide additional services such as debt underwriting and trading services, mutual fund supervisor, securities custodial services, securities registrar and sales support agent for a sale of investment units;¹¹⁸ and
- adopting the BIBF/PIBF scheme.¹¹⁹

In addition, some significant liberalization breakthroughs have been achieved prior to the financial turmoil including the decision by the Ministry of Finance in 1996 to grant additional full branches (outside Bangkok) to foreign commercial banks already operating commercial banking business in Thailand through full branches, subject to certain conditions.¹²⁰ Other example of the Thai Government's efforts to deregulate the financial sector includes the decision by the Ministry of Finance, in 1995, to allow the establishment of new commercial banks.¹²¹

2. Post-Financial Crisis Stage

The outbreak of the financial turmoil in Thailand since the latter half of 1997 has resulted in some dramatic changes being made to the long-held legal infrastructure of the Thai financial system including the foreign shareholding limits applicable to

117. *See supra* note 93.

118. *See* Bank of Thailand Circular Letter No. Thor.Por.Tor.Nor.Kor.(Wor) 1029/2535 Re: Application for a permission to operate addition business (June 1, 1992) (on file with the *Fordham International Law Journal*).

119. Bank of Thailand Circular Letter No. Thor.Por.Tor.Nor.Kor.(Wor) 1729/2535 Re: Bases Respecting Submission of Application for Permission to Operate International Banking Business (Oct. 5, 1992) (on file with the *Fordham International Law Journal*); Ministry of Finance Notification Re: Operation of International Banking Facilities by Commercial Banks (Sept. 16, 1992) (published in Government Gazette, vol. 109, pt. 119, Sept. 17, 1992). There have been subsequent amendments to the BIBF/PIBF scheme. *See, e.g.*, Bank of Thailand Notification Re: Bases, Procedures and Conditions Respecting Operations of IBF Business of Commercial Banks (No. 5), B.E. 2540 (Sept. 18, 1997) (on file with the *Fordham International Law Journal*).

120. Ministry of Finance Notification Re: Bases Respecting Granting Permission to Foreign Commercial Bank to Set Up Additional Full Branch (July 4, 1996) (on file with the *Fordham International Law Journal*). The eligible foreign commercial bank must possess the following qualifications: (i) its assets shall not be less than Baht 1,000 million; (ii) its operation must yield benefits to the economy of the country; and (iii) it must be a bank that plays a role in the development of knowledge in finance and commercial banking at international level, in respect to staff training and development of positions and duties within the bank.

121. Ministry of Finance Notification Re: Bases, Procedures and Conditions Respecting Application for Establishing of Commercial Bank (Nov. 29, 1995) (on file with the *Fordham International Law Journal*).

financial institutions in Thailand. As previously mentioned, the Royal Decrees empower the BOT to relax the foreign shareholding limit applicable to commercial banks and finance companies on a case-by-case basis.

Subsequent to the entry into force of the Royal Decrees and the Emergency Decrees on June 28, 1997 and October 25, 1997, respectively, the BOT issued a letter addressing its policy on shareholding – both domestic and foreign – in the financial institutions on November 11, 1997.¹²² Against the backdrop of the BOT's policy to require commercial banks and finance companies to increase their capital funds as a cushion against any potential loss from asset deterioration, the BOT, with the Ministry of Finance's approval, set the guidelines for the financial institutions' capital increase.¹²³ These guidelines are purportedly meant to apply to both foreign investors and Thai investors on an equal treatment basis.¹²⁴ Nevertheless, as it will be apparent, this is far from being the case.

The guidelines specify that foreign investors having sound financial conditions and the ability to increase the efficiency in the management of the financial institution in question shall be allowed to hold more than forty-nine percent of shares in the fifteen commercial banks, thirty-three finance companies (which are operating and not suspended), and twelve credit foncier companies for a period of ten years.¹²⁵ After ten years, the foreign shareholders will not be forced to sell their shares or reduce their shareholding. The foreign shareholders instead will be subject to passive dilution of their interests after ten years,

122. Bank of Thailand News Release No. 75/2540 Re: Guidelines for Equity Holding in Financial Institutions (Nov. 11, 1997) [hereinafter BOT Release No. 75/2540] (on file with the *Fordham International Law Journal*). It should be pointed out that the term "financial institutions" used in the Circular Letter does not include securities companies because securities companies are under the jurisdiction of the Securities and Exchange Commission, and the BOT only has a limited authority over securities companies.

123. *Id.*

124. The "equal treatment" is necessitated by the existence of legal limitations under the Commercial Banking Act that prohibits a *Thai commercial bank* (but not non-bank Thai investors) from owning shares of other Thai commercial banks (unless approved by the Finance Minister). See Commercial Banking Act, *supra* note 2, § 12(6) (prohibiting banks from holding shares in another commercial banks unless such shares have been acquired as result of debt settlement or guarantee in respect to credit granted).

125. See BOT Release No. 75/2540, *supra* note 120.

i.e., they will not be able to participate in any capital increase or purchase any additional shares after the lapse of ten years unless the amount of the then foreign shareholdings will be less than forty-nine percent.¹²⁶ The guidelines apply equally to bank and non-bank foreign investors.¹²⁷ A foreign bank investor that already has a full branch or a BIBF in Thailand will be allowed to continue its existing operation.¹²⁸ It is expressly provided, however, that the authorities reserve the right not to allow a foreign bank that has more than forty-nine percent interest in a Thai commercial bank to have an additional full branch in Thailand.¹²⁹

The similar framework applies in the case of a Thai commercial bank owning shares of another Thai commercial banks. A Thai commercial bank or finance company with a sound financial condition may own more than forty-nine percent interest in other financial institutions for a period of ten years.¹³⁰ After ten years, if the acquiring bank or finance company intend to maintain its majority interest in the acquired bank or finance company, an extension will be granted for another ten year period.¹³¹ During the extension period, the acquiring Thai bank or finance company will not be forced to sell its shares or dispose its shareholding in the acquired bank or finance company.¹³²

Responding to the BOT's initiative, some domestic commercial Thai banks have recently announced their recapitalization plans.¹³³ Other Thai banks have already completed their capital increase plan. For example, Thai Danu Bank, a mid-size bank, recently accepted an alliance with Development Bank of Singapore, which became the bank's majority shareholder. Other banks are not so fortunate. Due to the rapidly deteriorating assets and flight of deposits stemmed from the public's lack of con-

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.*

133. On February 26, 1998, Thai Farmers Bank and Bank of Ayudhya announced that they will increase capital by Baht 3.76 billion and Baht 15 billion, respectively. In addition, Thai Farmers Bank amended its foreign shareholding limit (as prescribed in its articles of association) from 25% to more than 49% of total issued and outstanding shares of the company. See *TFB and BAY Yield to Pressure for Capital Increase*, BUSINESS DAY Feb. 27, 1998.

fidence, the Thai Government was forced to take over the control and operation of three small banks and to install new management.¹³⁴ It is expected that eventually the fifteen Thai commercial banks will complete their recapitalization and some of them will dilute the stakes of family-controlled majority shareholders while at the same time conducting a private share issue to foreign investors.

IV. REGULATION OF THE SECURITIES INDUSTRY

The Stock Exchange of Thailand¹³⁵ ("SET") is the only official exchange in Thailand. Public limited companies, state enterprises, juristic persons established under special purpose legislation, or investment projects having the appropriate qualifications may file applications with the SET to have their securities listed on the SET.¹³⁶ The SET is responsible, among other things, for processing all listing applications, for ensuring that disclosure requirements for listed companies are met, and for monitoring all trading activities in respect of listed securities. It also acts, through its subsidiary, Thailand Securities Depository Co., Ltd. ("TSD"), as dividend paying agent, transfer agent, and registrar for the great majority of all listed Thai companies.¹³⁷

On February 28, 1992, the SEC Act was adopted into law, and it became effective May 16, 1992.¹³⁸ The SEC Act, which repealed the SET Act,¹³⁹ provided for the establishment of the

134. Bank of Thailand Announcement No. 5/1998, Announcement on Changes in Management and Directors of First Bangkok City Bank Public Company Limited, Jan. 23, 1998 (on file with the *Fordham International Law Journal*); Bank of Thailand Announcement No. 8/1998, Additional Measures to Strengthen the Financial System, Feb. 6, 1998 (on file with the *Fordham International Law Journal*).

135. The first organized stock exchange in Thailand was the privately sponsored Bangkok Stock Exchange ("BSE"), which was established in 1962. In May 1974, the Securities Exchange of Thailand Act B.E. 2517 ("SET Act") was promulgated. The SET Act replaced the BSE with the Securities Exchange of Thailand, which was renamed the Stock Exchange of Thailand in February 1991. The SET Act provided the basis for the regulation of the primary and secondary securities markets in quoted securities in Thailand and placed responsibility for the control of the SET with the Ministry of Finance.

136. See The Securities and Exchange Act B.E. 2535 (published in Government Gazette, vol. 109, pt. 22, Mar. 16, 1992) [hereinafter SEC Act].

137. See generally, *id.* §§ 219-29.

138. *Id.* The SEC Act came into force 60 days following the date of its publication in the Government Gazette except for some sections as specified in the SEC Act, which became effective on the day following the date of its publication in the Government Gazette.

139. *Id.* § 3.

Securities and Exchange Commission ("SEC"), which has power to introduce policies for the development and supervision of the securities markets and related activities in Thailand.¹⁴⁰ The SEC Act provides that no sale of newly issued securities¹⁴¹ by a public limited company will be permitted unless the SEC approval has been obtained and where a registration statement in the prescribed form together with a draft prospectus in respect thereof have been submitted to the SEC and have become effective.¹⁴²

While primary responsibility for the regulation of new securities issues has shifted to the SEC, the SET continues to operate the stock exchange (as an exchange authorized under the SEC Act), and is responsible for listing approvals¹⁴³ once SEC registration, prospectus, and related requirements have been met and the paid-up capital reflecting the shares offered in the offering has been registered with the Ministry of Commerce.

A. *The Securities Industry: Regulatory Framework*

The securities industry in Thailand is governed by the SEC Act. Under the SEC Act a company may be granted licenses to engage in six types of securities business, namely, brokerage for buying and selling securities, securities dealing, investment advisory services, securities underwriting, mutual fund management and private fund management, and other types of securities business as specified from time to time by the Finance Minister upon recommendation of the SEC.¹⁴⁴ Each of these activities requires a separate license. Most securities companies hold licenses for the first four types of licenses, and certain companies have been granted a mutual fund management license.

A foreign investor must execute trades of listed securities through a Thai licensed broker or sub-broker on the SET. A transaction of listed securities, however, can be carried out privately without the use of a broker if it is not effected on the

140. *Id.* §§ 8-31.

141. The term "securities" is defined in the SEC Act as treasury bills, bonds, bills, shares, debentures, mutual fund investment units, share warrants, debenture warrants, investment unit warrants and any other instruments as specified by the SEC.

142. *See* SEC Act, *supra* note 136, § 33. The sale of newly issued securities made entirely to its shareholders in consideration of full payment, i.e., rights offering, is outside the scope of the SEC Act.

143. *See id.* § 189.

144. *See generally id.* §§ 112-140.

SET.¹⁴⁵

The SET requires that bid and offer quotations for shares be at maximum spreads, depending on the market price per share and in accordance with a table of values, such that the minimum spread will usually be within one percent of the market price.¹⁴⁶ The SET has recently increased the maximum ceiling for price movements from ten percent to thirty percent;¹⁴⁷ the change, effective as of November 17, 1997, is expected to increase volatility on the SET.

Brokerage commissions payable by buyers and sellers of trades executed on the SET are fixed by the SET as a percentage of the trade's value.¹⁴⁸ The prescribed rates of broker commissions are as follows: (i) 0.5% of the total purchase price with a minimum of 50 baht per transaction for sale and purchase of ordinary shares, preference shares, or warrants on shares; (ii) 0.3% of the total purchase price with a minimum of 30 baht per transaction for sale and purchase of unit trusts or warrants on unit trusts; and (iii) 0.1% of the total purchase price with a minimum of 50 baht per transaction for sale and purchase of bonds, debentures, or warrants on debentures.¹⁴⁹

All settlement and clearance of transactions on the SET must be effected through the TSD on the afternoon of the third business day following the day of the transaction.¹⁵⁰ The TSD offsets sales and purchases of each member and only the net balance of securities and cash is delivered or received by the SET

145. Any capital gain realized from such off-the-exchange trades by individual investors, however, will be subject to the Thai capital gain tax because capital gains from the sale of securities transacted on the SET by an individual investor is exempted from tax.

146. SET Notification Re: Purchase and Sale through the Trading System (Aug. 15, 1996) (on file with the *Fordham International Law Journal*).

147. SET Notification Re: Purchase and Sale through the Trading System (No. 5) (Oct. 10, 1997) (on file with the *Fordham International Law Journal*); SET Regulation Re: Prescriptions regarding Sale and Purchase, Payments and Delivery of Listed Securities (No. 4) (Oct. 1, 1997) (on file with the *Fordham International Law Journal*).

148. SET Notification Re: Commission Rates in Connection with Brokers or Agents for Sale and Purchase of Listed Securities (No. 1), B.E. 2540 (Oct. 31, 1997) [hereinafter SET Notification Re: Commission Rates] (on file with the *Fordham International Law Journal*).

149. *Id.*

150. Guidelines of Thailand Securities Depository Co., Ltd. Re: Settlement and Clearance Services (No. 3) (July 2, 1996) (on file with the *Fordham International Law Journal*).

members through the TSD.¹⁵¹

1. The Stock Exchange of Thailand

The SET is a non-profit entity whose members are securities companies. At present, it is the only official stock exchange in Thailand. The SET is primarily responsible for processing all listing applications filed by public limited companies, state enterprises, juristic persons established under special-purpose legislation, and investment projects meeting the appropriate qualifications.¹⁵² On a daily basis, the SET has the duty to monitor the exchange to ensure that all trading activities of listed securities are carried out legally and smoothly. It must also ensure that listed companies disclose the required information.

The SEC Act also provides for the establishment of an over-the-counter market ("OTC Market") for companies that cannot otherwise meet SET listing requirements.¹⁵³ The first OTC market was opened on November 15, 1995. In addition, a plan to open an options and futures exchange is currently under study by the SET.¹⁵⁴ However, due to the financial crisis and the overall lack of experience in derivatives in Thailand, the SEC and SET have postponed the plan to open a derivative exchange and instead have announced that an over-the-counter derivative market, which is scheduled to become operational in the early part of 1999, will be used as a precursor to an official derivative exchange.¹⁵⁵

There are five separate boards on the SET on which trading takes place on computerized system: the main board for regular trading of ordinary shares, preference shares, and warrants; the odd-lot board for dealings in odd lots, bonds, debentures, and convertible debentures; the big lot board for dealings in large lots of securities; the foreign board for trading in shares registered in the name of or sold to a non-Thai person; and the cash

151. Guidelines of Thailand Securities Depository Co., Ltd. Re: Depository Services (No. 4) (July 2, 1996) (on file with the *Fordham International Law Journal*).

152. See Securities Act, *supra* note 138, §§ 204-17.

153. SEC Act, *supra* note 138, § 204.

154. Section 218 of the SEC Act only provides that the establishment, operation, supervision, and control of the operation of a futures and options centre shall be in accordance with the governing laws. At present, no official futures and options market or center exists in Thailand.

155. For details, see Supachai Arunthamsakul & Apisith John Sutham, *Over the Counter Derivatives Market*, CAPITAL ASIA, vol. 9, Issue No. 3, Apr. 1998.

board on which the sale and purchase of securities is settled on the same day.¹⁵⁶ Shares are traded in one board lot or multiples of board lots of 100 shares subject to certain stated maxima. Trading hours are between 10:00 a.m. and 12:30 p.m. and between 2:30 p.m. and 4:30 p.m. Monday through Friday, except on Thai public holidays.

2. Foreign brokers

Foreign brokers are not permitted to execute trades on the SET unless they are licensed.¹⁵⁷ However, under current SET regulations, SET member brokers are permitted to negotiate freely the sharing percentage of the fixed brokerage commissions with foreign brokers and sub-brokers. The regulation specifies that foreign brokers shall receive no more than forty percent of the fixed brokerage commission received by the SET member brokers.¹⁵⁸ In the event that there is a brokerage commission sharing agreement or arrangement between a foreign broker/dealer and a Thai broker and the transactions are executed through a Thai broker, regulations applicable to domestic brokers will also be applicable to such foreign broker/dealer. Recently, the SET has issued new regulations prescribing, among other things, conducts and obligations of foreign brokers under a brokerage commission sharing scheme.¹⁵⁹

B. *Recent Legal and Regulatory Developments*

1. Net Capital Ratio Requirements

a. Maintenance of net capital ratio

The SEC recently issued a series of measures aimed at strengthening the operation of securities companies. One of the measures is the new rules on net capital ratio ("NCR") require-

156. *Id.*

157. Announcement of the National Executive Council No. 281 (Nov. 24, 1972) (published in Government Gazette, vol. 89, pt. 180, special issue, Nov. 25, 1972). A brokerage business is one of the businesses that are expressly closed to aliens under the National Executive Council Announcement No. 281 (the so-called "Alien Business Law"). Category A of the Alien Business Law specifically excludes a brokerage business from the list of businesses permissible to aliens.

158. SET Regulation Re: Commission Rates, *supra* note 148.

159. SET Regulation Re: Rules, Conditions and Procedure Concerning Agency or Sub-Brokerage Contracts with Foreign Brokers with respect to Securities listed on the SET (Oct. 31, 1992) (on file with the *Fordham International Law Journal*).

ments.¹⁶⁰ NCR is defined as liquid assets¹⁶¹ minus total liabilities of the securities company, adjusted for risks.¹⁶² Effective from January 1, 1998, the new NCR rule, the main purposes of which is to tighten the current net capital ratio and to support new types of SEC-approved transactions such as short-selling/securities lending and securities repurchase, requires securities companies to maintain certain percentages of their net liquid assets as NCR reserves as follows.

- *From January 1, 1998, to December 31, 1998:* the NCR shall not be less than three percent of the securities company's general liabilities measured on a daily basis.
- *From January 1, 1999, to December 31, 2000:* the NCR shall not be less than five percent of the securities company's general liabilities measured on a daily basis. Moreover, securities companies will be required to calculate the risk on all debt instruments according to their credit rating.
- *From January 1, 2001, onwards:* the NCR shall not be less than seven percent of the securities company's general liabilities measured on a daily basis.¹⁶³

The basis for calculating the NCR shall be as prescribed by the SEC notification regarding calculation and report of the NCR.¹⁶⁴

With respect to the finance and securities company, it is required to maintain its NCR in the same manner as would a stand-alone securities company.¹⁶⁵ The finance and securities company, however, is obligated to separate the accounts of securities business from finance business pursuant to the BOT reg-

160. SEC Notification No. Kor.Thor. 37/2540 Re: Maintenance of the Net Capital Ratio (Oct. 15, 1997) (in Thai) [hereinafter SEC Notification No. 37/2540] (on file with the *Fordham International Law Journal*).

161. Liquid assets are defined as the aggregate of following assets: cash and bank deposits; securities purchased with agreement to resell including accrued interests; promissory notes and bills of exchange issued by the financial institutions; investment in securities and debt instruments; cash customers; margin customers and securities-borrowing customers; customers secured by collateral; and others as prescribed by the SEC notifications.

162. Net capital ratio ("NCR") is defined as the NCR after risk adjustment.

163. See SEC Notification No. 37/2540, *supra* note 160, art. 3(1)-(3).

164. Notification of the Office of the SEC No. Sor.Thor. 50/2540 Re: Calculation and Report of Net Capital Requirement (Dec. 24, 1997) (in Thai) [hereinafter Notification of the Office of the SEC No. 50/2540] (on file with the *Fordham International Law Journal*).

165. *Id.* art. 4.

ulations.¹⁶⁶ When calculating the NCR, the finance and securities company is to first calculate (x), the actual capital fund used in the finance business after making an adjustment for the capital adequacy requirements as prescribed by the BOT.¹⁶⁷ On the securities business' side, the finance and securities company is required to calculate (y), the actual NCR adjusted by the base NCR, which would result in compliance with the rule regarding maintenance of the NCR, as described above.¹⁶⁸ In the final analysis, the result of (x) and (y) should yield the value of not less than zero.

b. Calculations of NCR and NCR Report

As it was evident that most, if not all, of the securities companies and finance and securities companies would be unable to satisfy the new NCR requirements by the prescribed time period, the SEC provided that on the calculation of the NCR the securities companies and finance and securities companies were permitted to calculate their NCR based on the old NCR requirements subject to a few adjustments.¹⁶⁹ Thus, from January 1, 1998, to June 30, 1998, the securities companies and finance and securities companies will not be required to calculate their NCR on the basis of the new standards. Nevertheless, the securities companies are required to calculate investment value and margin collateral more realistically and to value as zero the value of shares with a "C" (compliance) or "SP" (suspended) sign exceeding seven days, debentures with payment default, and debt instruments of the suspended financial institutions. As from July 1, 1998, the securities companies and finance and securities companies will be required to calculate their NCR based on the new NCR requirements.¹⁷⁰

The securities companies and finance and securities companies are required to maintain the daily NCR account and submit

166. SEC Notification No. 37/2540, *supra* note 160, art. 4(1).

167. *Id.* art. 4(2).

168. *Id.* art. 4(3).

169. *Id.* art. 3(2).

170. Form Bor.Lor. 4/1 to SEC Notification No. Sor.Tor 50/2540. Form Bor.Lor. 4/1 is attached as an annex to the SEC notification No. Sor.Tor. 50/2540. Form Bor.Lor. 4/1 is a formula worksheet with detailed explanations to be used by the securities companies and finance and securities companies in their NCR calculation.

a NCR calculation made on the last business day of the month to the SEC no later than the seventh day of the following month.

c. Daily NCR Report

A securities company is required to submit the NCR calculation report to the SEC on a daily basis in the event that the NCR of the securities company at the end of any given day is equal to or less than the following:

- from January 1, 1998 to 31 December 31, 1998 – four percent of total liabilities;
- from January 1, 1999 to 31 December 31, 2000 – six percent of total liabilities; and
- from January 1, 2001 – eight percent of total liabilities.¹⁷¹

The reporting requirement shall continue until the NCR of the securities company satisfies the requirements for two consecutive business days unless otherwise approved by the SEC.¹⁷² As regards a finance and securities company, it is similarly subject to the daily reporting requirement in the case that its adjusted capital fund is less than or equal to one percent of its total liabilities with respect to its securities business.¹⁷³

2. Short Selling and Securities Lending

Until recently Thai securities companies were expressly prohibited from engaging in the practice of short selling and securities lending by virtue of Section 98(5) of the Securities and Exchange Act B.E. 2535 (1992) ("SEC Act"). Section 98(5) of the SEC Act provides that no securities company shall sell securities without having possession or without receiving an order to sell from another person unless the SEC issues a notification allowing such transactions. Over the years, the Thai capital market, however, has attracted over the years an increasing number of foreign institutional investors who are accustomed to a greater variety of investment options than those being offered on the Thai securities markets. Moreover, local investors, institutional or otherwise, have also grown more sophisticated and ap-

171. Notification of the Office of the SEC No. 50/2540, *supra* note 164, art. 5(a)-(c).

172. *Id.* art. 5(2).

173. *Id.*

pear ready to assume higher risks in relation to their investment portfolios.

As prescribed by the SET regulation concerning rules, conditions and procedures for short selling (No. 1) B.E. 2540 (1997), short selling shall be permitted as from January 1, 1998.¹⁷⁴ However, it should be noted that, practically-speaking, only institutional investors can transact short selling and securities lending for the time being. Non-institutional investors cannot conduct short selling and securities lending because: (1) the regulation of the "credit balance"¹⁷⁵ required for non-institutional investors is still being reviewed by the SET, and (2) to transact in the short selling and securities lending business, the SET's securities companies are required to install computerized systems to monitor the lent securities and the changes in market values of the securities on loan and collateral every business day.¹⁷⁶

The SEC notifications authorize commercial banks, finance companies, securities companies, and other financial institutions created under special law to conduct securities lending business.¹⁷⁷ The authorized financial institution is required to assess risks associated and to demand collateral from the counterparty.¹⁷⁸ The parties are also required to enter into a securities lending agreement as prescribed by the relevant notification of the Office of the SEC.¹⁷⁹ The same notifications also

174. SET Regulation Re: Rules, Conditions and Procedures for Short Selling (No. 1), B.E. 2540 (Oct. 29, 1997) (in Thai) [hereinafter SET Short-Selling Regulation] (on file with the *Fordham International Law Journal*); see also Apisith John Sutham & Supachai Arunthamsakul, *Short-selling and securities lending in Thailand*, CAPITAL ASIA, vol. 9, Issue No. 2, Mar. 23, 1998, at 23.

175. The SET has introduced the "credit balance" method to replace the existing margin system. The new margin system is expected to be in place by the end of February 1998.

176. See Sutham & Arunthamsakul, *supra* note 174.

177. SEC Notification No. Kor.Dor. 28/2540 Re: Application for License to Operate Securities Business Concerning Securities Borrowing and Lending Business (July 31, 1997) (published in Government Gazette vol. 114, pt. 66 Ngor., Aug. 19, 1997) (in Thai) [hereinafter SEC Notification 28/2540].

178. SEC Notification No. Kor.Dor. 29/2540 Re: Rules, Conditions and Procedures for Securities Borrowing and Lending (July 31, 1997) (published in Government Gazette, vol. 114, pt. 66 Ngor., Aug. 19, 1997) (in Thai) [hereinafter SEC Notification No. 29/2540].

179. Notification of the Office of the SEC No. Sor.Dor. 39/2540 Re: Features and Material Aspects of Securities Lending Agreement (Oct. 8, 1997) (in Thai) (on file with the *Fordham International Law Journal*).

prescribe, among other things, the maximum period of securities lending.

A SET regulation authorizes SET members to engage in short selling with respect to the authorized securities.¹⁸⁰ Both institutional and individual investors are permitted to engage in short selling although individual investors are required to transact their sales through the credit balance accounts.¹⁸¹ Other requirements include a prohibition on short selling by an insider (as defined in the SEC Act and the relevant SET notification).

a. Securities Lending Regulations

To operate the business of short-selling and securities lending, a business operator must be granted a license.¹⁸² The securities to be borrowed or lent must be securities for which the TSD or the BOT acts as a registrar.¹⁸³ The maximum lending period shall not exceed the maximum period as prescribed by the Office of the SEC. The current maximum lending period, effective as of October 9, 1997, is one year.¹⁸⁴ It should be noted that this maximum period is applicable to one transaction or a series of consecutive transactions with one lender or more.¹⁸⁵

An operator of short-selling and securities lending business, defined as either a lender or its representative, or a borrower or its representative, is required to perform several tasks prior to lending or borrowing any securities. A lender is required to analyze the risks of the counterparty and demand collateral from a borrower pursuant to the notification. The results of the risk analysis must be reported to the management pursuant to the lender's internal guidelines on securities lending, and the transaction must be approved by the operator's board of directors. Further, the securities lending agreement shall conform with the requirements of the Office of the SEC. In the case of any transfer of securities, the transfer of scripless securities between ac-

180. See SET Short-Selling Regulation, *supra* note 177.

181. For detailed explanations of how the credit balance system work, see SET JOURNAL, vol. 2, January 1998 (in Thai) (on file with the *Fordham International Law Journal*).

182. See SEC Notification No. 28/2540, *supra* note 177.

183. See SEC Notification No. 29/2540, *supra* note 178.

184. Notification of the Office of the SEC No. Sor.Dor. 37/2540 Re: Term of Securities Lending (Oct. 8, 1997) (in Thai) (on file with the *Fordham International Law Journal*).

185. *Id.*

counts for purposes of lending or returning the borrowed securities or depositing or returning the deposited collateral must be reported to the TSD or the BOT. Finally, an operator shall keep and maintain reports for securities lending pursuant to the SEC rules.¹⁸⁶

The collateral must be one of the following: Thai Baht currency cash; letters of credit; Thai Government bonds; U.S. dollar currency cash (only if the borrower is a non-resident); bonds issued by the BOT; bonds issued by state-owned enterprises and guaranteed by the government; or debentures that are rated BBB or above or the equivalent or the issuer of debentures that is rated BBB or above or the equivalent, or shares listed on the SET.¹⁸⁷

The collateral's value at any given time must not be less than the value of the borrowed securities as prescribed by the SEC notification. The market value of the borrowed securities and the collateral shall be marked to market values on a daily basis.¹⁸⁸

b. Short Selling Regulations

A securities company is authorized to conduct short selling transactions for its own proprietary trading or pursuant to a customer's order.¹⁸⁹ It is authorized to sell short on behalf of a customer provided that the securities company is certain that the customer possess the securities in question or the securities are deposited with another securities company.¹⁹⁰ The securities can be either shares or debentures. In the case of shares, the shares must be shares listed on the SET (or registered with the over the counter center) pursuant to the SET regulation. Individual customers are to be notified by the securities company of the potential risks involving use of short selling techniques.¹⁹¹

186. See SEC Notification No. 29/2540, *supra* note 178, ¶ 6(1)-(4).

187. *Id.* ¶ 9; see also Notification of the Office of the SEC No. Sor.Dor. 36/2540 Re: Prescriptions Concerning Collateral in Securities Borrowing and Lending (Oct. 8, 1997) (in Thai) (expanding scope of what may constitute collateral) (on file with the *Fordham International Law Journal*).

188. *Id.*

189. See SEC Notification No. Kor.Dor. 30/2540 Re: Short Selling by Securities Companies (July 31, 1997) (published in Government Gazette, vol. 114, pt. 66 Ngor., Aug. 19, 1997) (in Thai).

190. *Id.*

191. *Id.* ¶ 4(1).

c. Regulations Concerning Securities Lending Agreement

A securities lending agreement ("Agreement") must contain the following broad material terms:

- objectives of securities borrowing and lending;¹⁹²
- securities to be borrowed and the collateral;¹⁹³
- adjustments of volume or value of the borrowed securities or collateral;¹⁹⁴
- indemnification relating to dividend, interest, or other distributions entitled to receive by the parties;¹⁹⁵ and
- defaults resulting in the debt being due immediately.¹⁹⁶

3. Over-the-Counter Derivatives

Prior to January 30, 1998, Thai securities companies were expressly prohibited from purchasing and selling futures and options on securities (whether in their own names or for customers) unless the SEC issued a notification permitting such transactions by virtue of Section 98(4) of the SEC Act.¹⁹⁷ However, it became clear to the Thai authorities that its financial and capital

192. It is necessary that the objective of the agreement will enable a borrower to deliver the securities sold or to be sold in Thailand or to return the borrowed securities.

193. The securities to be lent shall be free and clear of any special right or obligations. A borrower shall deliver collateral to a lender as security for the debt and a lender shall return the collateral to a borrower upon the return of the borrowed securities. The borrowed securities or collateral and the returned securities or collateral are fungible, provided that the securities or collateral have been issued by the same legal entity and the securities are of the same type, unit, and value.

194. The securities lending agreement shall contain unambiguous terms relating to any adjustment to be made to the value or number of securities or collateral if any one of the following events occurred during the borrowing period, as a result of which the rights of a lender or a borrower are affected:

- rights offering;
- change to the par value resulting in the increase or reduction of shares;
- redemption of securities;
- amalgamation, merger, or tender offer;
- distribution of shares as dividends;
- conversion of securities; and
- any other similar occurrences.

195. The agreement must contain terms relating to indemnification to a party with respect to any entitlement including dividend and interest as the case may be. The indemnification shall not be less than the distribution given to the securities' holder unless the parties agree otherwise.

196. The agreement shall contain unambiguous terms relating to the parties' rights, duties, and responsibilities, as well as the governing procedures, in the event that one of the parties has defaulted or certain events have occurred resulting in the debt being immediately due and payable.

197. SEC Act, *supra* note 138, §98(4) (stating that "[n]o securities company shall

markets must be developed in order to provide a greater depth and variety of investment options for investors.¹⁹⁸ To create a regulatory framework for derivative markets and intermediaries, the SEC is currently studying a derivative law, which is expected to become effective in June 1999.¹⁹⁹

Thus, on February 16, 1998, the SEC gave a green light to securities companies to set up an OTC derivative market.²⁰⁰ The SEC notification provides general approval for derivative transactions conducted for the purpose of hedging the risks. This notification also gives approval for derivative transactions conducted for the purpose of speculation. In the case of speculative transactions, the securities company must notify the SEC before the company commences trading. In addition, the securities company in question must meet the following qualifications:

- the board of directors' approval to engage in derivative transactions for speculative purposes must be obtained; and
- the appropriate control and risk administration must be set up.

Further, the SEC notification approves derivative transactions for the purpose of client service (which includes the derivative advisor). In this case, approval from the SEC is required and the securities company must maintain the following:

- the board of directors' approval to engage in derivative transactions for speculative purposes must be obtained;
- the appropriate control and risk administration must be set up;
- the appropriate qualifications for being a reputable contractor with customers, i.e., a good financial standing, sales practice control, must be in place; and

... purchase and sell futures and options on securities whether in its own name or for customers unless the SEC issues a notification allowing such transactions.”).

198. For more details, see OFFICE OF THE SECURITIES EXCHANGE COMMISSION, THAILAND, ISSUES CONCERNING THE POTENTIAL FOR DEVELOPING A FUTURES/OPTIONS EXCHANGE FOR THAILAND (1994).

199. As contemplated by the Act, the underlying products will include only financial products and derivatives are divided into the following: forward type, options type, other types of agreement specified by the SEC, and a combination of the above.

200. SEC Notification No. Kor.Tor 5/2541 Re: Derivative Businesses Permissible to be Conducted by Securities Companies (Feb. 16, 1998) (on file with the *Fordham International Law Journal*). See generally, Supachai Arunthamsakul & Apisith John Sutham, *Over the Counter Derivatives Market*, CAPITAL ASIA, vol. 9, Issue No. 3, Apr. 1998.

- expertise in derivatives and risk management including the related experiences are be required.

In addition, according to the SEC notification, the securities company that is approved to conduct the derivatives transaction, either for hedging or speculative purposes, can deal only with the local or foreign financial institutions or in the exchange recognized by the SEC. Similarly, the securities company that is approved to conduct the derivative client service business can serve only institutional investors. It should be noted that, in this regard, the securities company must exercise its best efforts to evaluate the readiness, knowledge, and understanding of the client in the derivative transaction. In this early stage, the underlying assets or variables must be the governmental bonds, state-enterprise bonds guaranteed by the government, securities, Thai securities indices, interest rates, and any monetary currencies only. The securities company that is approved to conduct the derivative speculation and client service must maintain the qualifications mentioned above at all times. In addition, the standard for the fund adequacy calculation system fixed by the SEC, or any other higher standards approved by the SEC, is required. Finally, the securities company that is approved to conduct the client service business must comply with the concerned rules on sales practices fixed by the SEC, i.e., client analysis, “know your customers” rules compliance, appropriate product offerings, risk disclosure, and client’s confidential information treatment.²⁰¹

4. Foreign Ownership in Thai Securities Companies

The cabinet recently approved a draft of the royal decree permitting foreign investors to engage in the securities brokerage business²⁰² (“Decree Authorizing Foreigners to Engage in the Brokerage Business” or, in short, “Foreign Broker Decree”), and it is expected to become law no later than the middle of 1998. The Foreign Broker Decree, once adopted, will waive the forty-nine percent foreign shareholding restriction in respect of securities companies that are licensed to engage in brokerage

201. *Id.*

202. *See* Draft Decree Authorizing Foreigners to Engage in the Brokerage Business Pursuant to Category A Annexed to the National Executive Council Announcement No. 281 (Nov. 24, B.E. 2515 (1972)) (in Thai) (on file with the *Fordham International Law Journal*).

business.²⁰³

As conditions for obtaining permission to engage in the securities brokerage service by way of acquiring up to 100% shareholding in Thai securities companies or finance and securities companies under the Foreign Broker Decree, the foreign investor must satisfy the following requirements:

- the foreign investor must already be engaging in the securities brokerage business;
- the amount of investment brought into the Kingdom must not be less than 500 million baht;
- the foreign investor must be allowed to engage in the securities brokerage business for the period of ten years from the date the Department of Commercial Registration receives notice from the foreign investor that it is engaging in the securities brokerage business; and
- foreign directors, advisers, and employees of the securities company whose shares are majority-owned by foreigners shall reside in the Kingdom not less than 120 days per year.²⁰⁴

Concomitantly, the Ministry of Commerce has drafted a ministerial regulation (“Ministerial Regulation”) addressing the related issue of non-brokerage securities services that are part of the securities company’s licensed securities business. Chapter 3(1) of Category C annexed to the Alien Business Law provides that services businesses that are not included in Category A or Category (which are closed to aliens) are, subject to approval by the Ministry of Commerce, open to aliens. For the avoidance of doubt, the Ministerial Regulation upon becoming effective prescribes that, as conditions to obtaining a license to conduct certain (non-brokerage) securities businesses that fall under Category C’s Chapter 3(1) services businesses, the foreigner or foreigners who brought into Thailand not less than 500 million baht to invest in a Thai securities company or finance and securi-

203. Pursuant to Category A of the National Executive Council Announcement No. 281 (Nov. 24, B.E. 2515 (1972)) (the so-called “Alien Business Law”), a foreigner or alien is prohibited from engaging in the brokerage business (including securities brokerage). See Chapter 3(5) of Category A annexed to the Alien Business Law. The royal decree upon adoption will allow foreigners to hold shares greater than 50% of the total issued and outstanding shares of a licensed securities company engaging in the brokerage business.

204. *Id.*

ties company shall be required to observe the following requirements:

- the ratio of capital to debts to be used in the permitted business is equal to zero;
- the ratio of capital funded by Thai nationals to capital funded by aliens to be used in the permitted business is equal to zero; and
- the ratio of Thai national directors to foreign directors in the permitted business is equal to zero.²⁰⁵

CONCLUSIONS

Given the current pace of deregulation and liberalization of the financial services sector in Thailand, it can be expected that the Thai financial services sector is on its way to becoming fully deregulated and liberalized. In this regard, the Thai government's ambition is to accelerate the pace of deregulation and liberalization and maintain the momentum of financial and regulatory reform. Its goals include a plan to put in place stringent new financial regulations and overhaul the entire regulatory regime with respect to financial institutions by the end of the year 2000.²⁰⁶ As discussed throughout this Article, the centerpiece of the financial and regulatory reform is the equal and nondiscriminatory treatment of foreign investors within the financial services sector. In the final analysis, it could be said that in the future it will not be necessary for the barbarians to burn the gate down; instead a gold-gilded invitation card will be printed and sent out to the heretofore unwelcomed guests.

205. *Id.*

206. The Ministry of Finance recently announced a timetable for proposed stricter lending regulations and other stringent new comprehensive regulations soon to be imposed on commercial banks and financial institutions. According to the Finance Minister, this is necessary to bring about transparency, bolster confidence among foreign investors, stimulate inflow of foreign capital, and engender greater stability in the baht's exchange rate. The Finance Minister was quoted as saying that "the new regulations would make our [Thai] financial institutions and the financial sector as a whole among the best in the world." *Tarrin Touts Benefits of New Banking Regulations: Transparency will lead to confidence in financial system*, BUSINESS DAY, Mar. 24, 1998, at 1.