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Corporate Governance of Banks in Thailand

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1. Introduction: Asian Crisis and the Banking Sector Problems

The banking sector has been one of the most important sectors in Thailand. The size of the banking sector has been much larger than the Thai stock market. Table 1:1 shows that the ratios of banks' total assets to GDP were over 100% throughout the period 1996-2003. The ratio of the market capitalization to GDP, however, ranged from 27.4% to 80.7%. Among financial institutions, commercial banks have dominated the financial sector in terms of size, lending, and deposits. So, banking problems can easily affect the economy negatively.

The bad loan problems that bankrupted a number of banks and financial companies came out around 1996. The problems started with the difficulties of Bangkok Bank of Commerce. About six months later, the finance companies began to experience similar difficulties and the downward spiral led to massive interventions by the government. Overall, 58 finance companies were suspended in 1997, a further 12 finance companies in 1998, and one in 1999. In relation to banking, the first intervention began in 1998 when six banks were suspended to be followed by one more in 1999. As a result of bank consolidations and closure, the number of banks declined from 15 in 1996 to 13 by 2001. Out of the 15 domestic banks operating in 1996, one was closed down, three were merged with government owned banks, two were taken over by the government and three became foreign owned. The remaining banks have been struggling to recapitalize on their own.

Weak corporate governance and prudential controls were thought to be the most important factors that caused the banking crisis (Siamwalla, 2001). Weak corporate governance allowed banks to engage in risky lending that was based on overvalued collateral and connection (Charumilind, Kali, Wiwattanakantang, 2006). The sharp drop in the stock and real estate markets combined with the rise in interest rates in 1996 aggravated banks' liquidity and solvency problems.

The most notable incident concerned Bangkok Bank of Commerce (BBC), a medium sized bank. According to the Nukul Commission (1998)[1], BBC extended massive loans to its executives to engage in takeover activities with no collateral and contract. In June 1996, the Thai government accused the bank's president (who was also the major shareholder), advisor, and a close friend of the bank's president of defrauding the bank of 2.2 billion baht. By the time when BBC collapsed in 1996, the bank had bad debts of about 98% of its total loans, requiring an injection of almost 100 billion baht in public money. The fall of BBC represented an early sign that eventually led to the 1997 financial crisis.

[1] The Nukul Commission Report was prepared for the government in 1998 with the objective to identify the causes of economic and mismanagement and corruption in the Bank of Thailand (BOT). The report provides recommendations to improve the efficiency of the financial system and reforms of the BOT. The Chairperson of

While superficially this situation resulted from poor quality loan portfolios, the underlying issues that led to this situation included corruption and the failure of the banks' risk management system. Moreover, the practices of rescuing troubled banks over the past by the financial authorities created moral hazard and promoted banks' excessive risk-taking. The implicit full guarantee also hampered market discipline by depositors and creditors. Besides weak corporate governance at banks, poor bank supervision and examination by the authorities were also responsible to connected lending and management fraud. Until 1996, the Bank of Thailand (BOT) had punished neither financial institutions nor their executives for lending to risky projects. For example, the BOT failed to detect the seriousness of the BBC's problems with NPLs that began in 1991 (Nukul Commission, 1998). Hence, the BOT did not take appropriate actions such as replacing the bank's incumbent management and reducing its capital. The BOT only stepped in when there was a run on bank deposits in 1996.

In this study, we review the policy responses to the financial sector crisis and the restructurings taken by the government and banks since 1997. We show that massive restructurings have been undertaken to strengthen the soundness and stability of the banking system. At the country level, the government implemented various measures to improve the central bank's capacity in supervising and examining the financial sector and enhance the effectiveness of corporate governance of Thai financial institutions. At the bank level, a number of restructurings were undertaken which included the disposal of bad loans and the establishment of good corporate governance and risk management system.

We also review government efforts to reform corporate governance of banks, ensure safety nets of the Thai financial system, and strengthen market discipline in the banking sector. More importantly, we evaluate the effectiveness of the current banks' internal corporate governance mechanisms and the government's policy efforts to enhance corporate governance in the banking sector.

The paper is organized as follows. Section 2 reviews measures implemented by the government to restructure banks and restore the financial sector. Among them were the policy efforts to enhance corporate governance of banks. Section 3 discusses the safety net frameworks with the focus on the evaluation of the blanket guarantee and the role of prudential regulation. This section also discusses the role of regulators. Section 4 addresses the effectiveness of internal corporate governance mechanisms of Thai banks and the measures to improve corporate governance by the government using the results drawn from the survey. Section 5 evaluates the strength of market discipline in the Thai banking sector. In addition, this section shows the ownership and control of Thai commercial banks and addresses the effects of the crisis on the banks' control structure. Section 6 summarizes the findings and provides some policy implications.

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the commission was Nukul Prachuabmoh, a former governor of the BOT. Other members include several leading economists and lawyers.

Insert Table 1:1 here

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2. Evolution and Restructuring of the Banking Sector

In this section, we review the banking problems and restructuring measures implemented both by the government and banks to cope with the problems that emerged from the 1997 financial crisis. We also investigate how the ownership structure of Thai financial institutions has changed enormously as a result of bank failures and drastic restructurings. Finally, we describe the policy efforts to promote effective corporate governance of banks.

Restructuring Measures Implemented in 1997-1998

By August 1997, 58 finance companies were insolvent and their licenses were suspended while 33 of 91 financial institutions were deemed viable and continued operating. To restore public confidence in the remaining operating institutions, the government, with the support and advice of the International Monetary Fund (IMF), initiated several programs to stabilize the macro economy and restore the financial market stability (Flatter, 1999; Santiprabhob, 2003).

The immediate measure implemented was the introduction of a blanket guarantee in August 1997, with a view to restoring public confidence in the banking industry. The BOT also tightened the rules for establishing capital adequacy and defining the provision of non-performing loans. To restore the effectiveness of the financial industry and increase transparency and competition in the financial sector, the government improved prudential regulations and introduced a supervisory regime. In 1997 and 1998, several emergency amendments to the BOT, commercial banking and finance company laws were passed to enable the authorities to intervene promptly in regard to nonviable financial institutions.

In October 1997, the Thai government announced a comprehensive restructuring plan for the banking and financial sector. The plan included the following measures: (i) setting up the Financial Sector Restructuring Authority (FRA) and Asset Management Companies (AMCs) to provide a framework for the initial disposal of the assets of nonviable financial institutions and restoration of the financial system, (ii) introducing international standards governing loan classification and provisioning and the interest accrual for financial institutions, and (iii) establishing a deposit insurance scheme.

To reestablish stability in the financial system, the government required the undercapitalized financial institutions to strengthen their capital base. To facilitate the process of recapitalization, in June 1997 the restrictions on the foreign ownership in financial institutions were relaxed from 25% to 100% for a period of 10 years. After 10 years, foreign shareholders could maintain or lower but not raise their stakes in financial institutions until the stake is less than 50%.

The first wave of bank intervention began in early 1998. The banks involved were Bangkok Metropolitan Bank, Bangkok Bank of Commerce, Siam City Bank, and First Bangkok City Bank. In August 1998, another two banks, Laem Thong Bank, Union Bank of Bangkok were the subjects of intervention, and BBC was closed down. In total, the government intervened in seven banks out of 15 banks.

An extensive restructuring plan was initiated on August 14, 1998 under the title “August 14 financial restructuring package”. The plan was to disentangle the financial crisis, strengthen banks’ deposit base, and overhaul credit flows to productive sectors. To accelerate the resolution of distressed financial institutions, two banks were nationalized. To recapitalize viable financial institutions, the government provided capital support. Two banks received tier 1 capital support in the form of 10 years government bonds in exchange for preferred shares. Another three banks received capital injection in the form of government bonds in exchange for their subordinated debt.

Under the restructuring process, Thai banks raised 959 billion baht (Bank of Thailand, 2000). Of this amount, the government contributed 293 billion baht, of which 241 billion baht was injected to state banks (including private banks intervened by the government). Another 10 billion baht of the government’s funds was provided to a number of finance companies (Siamwalla, 2001).

The government also implemented various measures to deal with the intervened banks individually. The time schedule of the implementation of the measures is presented in Table 2:1.

(1) Bangkok Bank of Commerce (BBC): The good assets were transfer to the government owned Krung Thai Bank (KTB). All the NPLs were kept at the bank. The BBC was turned into an Asset Management Company (AMC). The employees were laid off with full compensation. The Financial Institutions Development Fund (FIDF) converted all the loans provided to the BBC to the KTB’s capital.

(2) First Bangkok City Bank (FBCB): All of its assets, liabilities and staff were transferred to KTB. The FIDF provided a yield maintenance and gain/loss sharing scheme as part of the package.

(3) Laem Thong Bank (LTB): Radanasin Bank (RSB) absorbed LTB. RSB was established in March 1998 to manage good assets acquired from the 56 closed finance companies. Depositors and creditors of LTB were transferred to RSB. The staff remained employed and received the same remuneration. RSB was later acquired by United Overseas Bank (UOB) and renamed UOB Radanasin Bank (UOBR). The FIDF offered yield maintenance and gain/loss sharing arrangements to UOBR.

(4) Union Bank of Bangkok (UB): UB was consolidated with the government owned Krung Thai Thanakit Finance (KTT) together with another 12 intervened finance

companies. The consolidated identity became a bank, Bank Thai (BT). The staff of UB remained employed and received the same remuneration.

(5) Bangkok Metropolitan Bank (BMB) and Siam City Bank (SCIB): The two banks were nationalized. In 2002, BMB was consolidated with SCIB. SCIB was assigned to be the core bank because of its larger asset base. All of the BMB’s assets, liabilities and employees were transferred to SCIB.

(6) Nakornthon Bank. It was nationalized in 1999, then recapitalized and sold to Standard Chartered Bank in 1999.

In addition to the government’s recapitalization program, major banks were able to recapitalize on their own by raising funds through issuing shares and capital securities to foreign investors. Consequently, many banks became foreign owned. The Development Bank of Singapore acquired about 50.3% of the shares of Thai Danu Bank. Similarly, about 75% of the shares of Bank of Asia were acquired by ABN-AMRO Bank of the Netherlands.

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Insert Table 2:1 here

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Dealing with Impaired Assets

To deal with the extent of non-performing assets at financial institutions, the government encouraged debt restructuring in both financial and corporate sectors. Legal, regulatory, and tax reforms were introduced to establish an effective debt restructuring framework. The major law reforms include the amendments of the bankruptcy law in 1998, the bankruptcy law reforms in 1999, and the establishment of the bankruptcy court in June 1999.

Corporate Debt Restructurings by CDRAC

In June 1998, a debt workout framework “the Bangkok Approach,” which was modeled after the London Approach, was implemented. To facilitate out-of-court voluntary debt restructuring and to develop a framework for corporate debt restructuring, the Corporate Debt Restructuring Advisory Committee (CDRAC) and the Joint Public-Private Resolution were established. The CDRAC is responsible for outlining an efficient debt restructuring procedure and overseeing out-of-court debt settlements between corporate debtors and financial institutions. The CDRAC’s processes encourage voluntary debt negotiations based on a market-oriented approach. The BOT provides numerous incentives for successful debt restructurings, such as tax exemptions and land-transfer fee reductions (Dasri, 2002).

The majority of the cases signing into the CDRAC’s process have been successfully completed. Specifically, over the period 1998-2004, 14,358 cases with approximately 1.9

trillion baht worth of credits (accounting for 66.7% of all target debtors' value of credits) have gone through the restructuring process. However, 2,653 debtors with outstanding credits of around 0.4 trillion baht (14.5%) failed to restructure their debts and have then been taken to the court by creditors. These figures represented only the restructuring of small-sized bad assets of financial institutions since most of the large debtors were transferred from the CDRAC to private asset management companies (AMCs) and the Thai Asset Management Company (TAMC) in 2002.[2]

Corporate Debt Restructurings by TAMC

In June 2001, the TAMC was established to clean up the state banks' balance sheets by taking over all the banks' NPLs. It was necessary to deal with the impaired assets of banks that were transferred from government-owned financial institutions to asset management companies. In addition, the TAMC also dealt with the bad loans at private banks. But, these NPLs had to be secured and unstructured. The loans had to be held by multiple creditors and the amount had to be more than 5 million baht. The TAMC was granted extensive enforcement powers to collect loans from the banks' debtors. The TAMC could demand the court to foreclose on the collateral or personal guarantee of loans if debtors did not cooperate with the TAMC (Siamwalla, 2001).

By the third quarter of 2004, the TAMC had acquired 15,491 cases of impaired assets with combined book values of 777.2 billion baht. Out of these cases, 14,864 cases with book values totaling 629.8 billion baht were transferred from state-owned financial institutions. The remaining 1,085 cases with book values totaling 147.4 billion baht were transferred from private institutions. Figures 2:1 and 2:2 reveal that the NPLs had been decreasing gradually over time. By the end of 2003, the NPLs accounted for approximately 10% of the total loans which had been significantly reduced from around 50% in the mid of 1999.[3]

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Insert Figure 2:1, Figure 2:2 here

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[2] AMCs are set up by banks and finance companies and regulated by the Bank of Thailand under the Asset Management Company Act B.E. 2541 (A.D. 1998). The primary role of an AMC is to handle non-performing assets that were transferred from financial institutions. Impaired assets under the AMCs' management may be resolved through debt restructuring, foreclosure and sale of assets, or legal actions.

[3] From 1998 to December 2002, the NPLs are defined as a loan that has stopped payment on principal and interest for at least 3 months, excluding doubtful-of-loss loan with full provisioning. From December 2002, the NPLs are defined as loans that are classified as substandard, doubtful, doubtful–of-loss, and loss, including the doubtful-of-loss loans having been written off earlier, and were written back.

The Ownership Structure of Banks

This section investigates the ownership of banks. Unlike non-financial firms, banks operate under legal and regulatory environments that are substantially different from those of non-financial firms. Under the Commercial Bank Act B.E. 2505 (A.D. 1962), a person is allowed to hold at most 5% of the shares in a commercial bank.[4] However, the law does not limit the ownership by the Crown Property Bureau and other government agencies such as the FIDF. Until June 1997, foreign ownership of banks was limited to 25%. After the financial crisis, the restrictions were relaxed to allow for foreign ownership of 100% for a period of 10 years. Subsequent to that period, foreign investors will not be permitted to acquire additional shares and these shares must not be acquired until the ownership stake is maintained below 50% of the banks' total shares.

To calculate ultimate ownership, we use the standard method suggested by La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1999) and Claessens, Djankov, and Lang (2000). We consider four types of shareholders: Family, the Crown Property Bureau (CPB)[5], state, and foreign investors. The "state" here includes any government agencies including the MOF, the FIDF, the Royal Thai Army, the Royal Thai Navy, and the Royal Thai Air Force.[6]

The information on shareholdings is obtained from the I-SIMS and SETSMART databases produced by the Stock Exchange of Thailand. We also use the database of the Business Online Company (BOL) to trace ultimate ownership of non-listed companies that are shareholders of banks.[7] Finally, family relationships were obtained from Anuchitworawong, Souma, and Wiwattanakantang (2004).

Table 2:2 presents the identity of the largest shareholder of Thai banks in 1996, 2000, and 2003. The crisis significantly affected the ownership of the banks. The number of banks was reduced from 15 to 13 in 2003 due to bankruptcy, consolidations, recapitalization, and emergence of three new banks (Bank Thai, UOB Radanasin Bank, and Thanachart Bank). Table 2:3 shows that before the crisis, most of the Thai banks were controlled by families. There were only two banks owned by the state and there was no single bank in which a foreign investor was the largest shareholder.

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[4] A person includes his spouse and minor children, as well as a company in which they separately or aggregately own more than 30% of the shares.

[5] The CPB is a juristic person established in 1948 under the provision of a special Act of Parliament. It functions as the holding company of the Royal Family.

[6] Our definition, therefore, is different from the BOT. While we define Thai Military Bank as a state owned bank since its largest shareholders were the Royal Thai Army, the Royal Thai Navy, and the Royal Thai Air Force, the BOT considers the bank as privately owned for the fact that the largest shareholder is not the Ministry of Finance.

[7] The BOL obtains the right from the Ministry of Commerce to reproduce the company information that is filed with the Ministry annually. This database includes all companies in Thailand that have registered with the Ministry of Commerce.

In the post-crisis period, where families were the largest shareholders, there were only five banks in 1998, two banks in 1999 and only one bank in 2001-2003. Out of 15 banks in 1996, only three banks had their previous largest shareholder remained at the end of 2003. These banks were Bank of Ayudhya, the Siam Commercial Bank, and the state owned Krung Thai Bank. Among the three banks, the Ratanarak from Bank of Ayudhya is the only founding family who had managed to remain the controlling shareholder over the bank. In order to keep control on the bank, the Ratanarak sold about 25% of the shares in Siam City Cement to Swiss investors (Hewison, 2000). Other founding families who had been controlling shareholders of the banks for decades, namely the Sophonpanich (Bangkok Bank), the Lamsam (KasikornBank), the Wang Lee (Nakornthon Bank), and the Techapaibul (Bangkok Metropolitan Bank), lost the control as major shareholders. The Sophonpanich and the Lamsam continued to have their influence over the banks as the top executives and the board.

Tables 2:4 shows voting rights and cash-flow rights held by the largest shareholder. The ownership of banks became more concentrated in the post-crisis period compared with the pre-crisis period. The troubled banks that were nationalized emerged with the government as the majority shareholder. Similarly, all of the banks that were acquired by foreign institutional investors also turned out to have a high ownership concentration. Shareholdings by family, however, had declined significantly. Overall, the voting rights held by a family were reduced to less than 4% since 2001.

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Insert Table 2:2, Table 2:3, Table 2:4, Table 2:5 here

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Policy Efforts to Enhance Corporate Governance of Banks

Since the crisis, corporate governance has been the focus of extensive reforms in Thailand. In February 2002, the "National Corporate Governance Committee" (NCGC) was established to introduce policy measures to improve the level of corporate governance. The NCGC appointed six sub-committees. Among them was the Sub-Committee on the Enhancement of Corporate Governance in Commercial Banks, Finance Companies, and Insurance Companies.[8] In addition, the government introduced numerous measures, guidelines, and regulations to improve corporate governance of banks in Thailand. This section reviews these policy efforts.

[8] The Chairperson of the sub-committee is the Governor of the BOT, and its members include the President of Thai Bankers' Association, the President of Association of Finance companies, Director-General of Department of Insurance, and the Assistant Governor of the BOT who leads the Financial Institution Policy Group.

Guidelines for Improving the Effectiveness of the Board

Several initiatives have been launched by the authorities to enhance the effectiveness of the board of directors in the Thai commercial banking sector. In March 2002, the BOT issued the Financial Institution Directors' Handbook. The Handbook elucidates the fiduciary duties of directors, the role of the board of directors in formulating strategies and policies as well as monitoring and overseeing the management, and the expectations of stakeholders such as shareholders and depositors. The Handbook also specifies the regulations governing duty of care, which if violated, may lead to criminal liabilities and cases of directors' liability.

In December 2002, the BOT issued guidelines and rules for the restructuring of the composition, qualifications, and responsibilities of the board of directors and sub-committees in the banks. The new guidelines require that a board must have at least nine members, out of which more than one-third has to be non-executives. In addition, at least three board members or one fourth of the members, whichever is higher, must be independent directors.

An outside independent director has to be a person who (1) is not an employee of the bank, (2) does not have a family relationship with top executives and major shareholders of the bank, (3) does not directly and indirectly own more than 0.5% of the bank's shares, and (4) does not have direct and indirect interests in related entities of the bank or that of its major shareholders.

Directors cannot be: (1) politically appointed persons, (2) from financial supervising institutions, and (3) persons who were removed from public offices due to fraud and mismanagement. Directors are not allowed to serve as directors for other banks simultaneously. These restrictions, however, can be relaxed with the BOT's approval. Directors are also prohibited from being the Chairperson, executive director, or director with signatory authority in more than three business groups.[9] To enhance board monitoring, a director is also required to attend at least 50% of the annual board meetings.

In December 2002, the BOT required that banks have to set up audit and risk management committees. The audit committee must have at least three members, two of whom have to be independent directors. The Chairperson of the audit committee must not serve as a member of other committees. The risk management committee consists of at least five members who may come from the bank's board and/or top management. The committee is to be chaired by the bank's CEO.

Banks were urged to set up two other committees: nomination and compensation committees to oversee the appointment and compensation of directors, committee members, and top management. These two committees may have the same members. The number of the committee members has to be at least three, and all of the members should be non-executive

[9] Until 2003, directors were allowed to assume such positions in no more than three *companies*.

directors. The BOT also advises that the Chairperson of the committees should be an outsider. The committees should hold meetings at least twice a year.

Regulations on Senior Management

According to the Commercial Banking Act B.E. 2522 (A.D. 1979), top executives of banks cannot be those who have been dismissed from public offices due to fraud or have been through bankruptcy. In November 1997, the BOT issued additional requirements. A bank's top management must have at least five years experience as senior management at established financial institutions. In addition, top executives must have a good ethical business background with commendable work record and no record of imprisonment.

Regulations on Information Disclosure

To enhance transparency and promote effective market discipline, in May 2001 the BOT ordered banks to disclose details of the following information.

(1) Transactions that are related to a bank's senior management and companies in which they hold at least 10% of the shares.

(2) Financial and non-financial compensation and other benefits paid to directors and senior management.

(3) Non-performing loans (NPLs).

(4) Loans to related parties.

(5) Violations against the BOT's rules and regulations, and the amount of fine paid on such violations. This information must be disclosed on a monthly basis.

Guidelines for Internal and External Controls

Internal Audit and Control

To improve the effectiveness of internal audit and control procedures, in October 2001 the BOT announced guidelines that specify the responsibilities of internal auditors, the scope of auditing, and BOT reporting requirements. These guidelines are to be applied to a group-wide internal auditor or an outsource of such duty of a commercial bank. In addition, internal auditors are encouraged to apply other guidelines for internal control issued by other organizations, such as the Institute of Internal Auditors (IIA), the Committee of Sponsoring Organizations of the Treadway Commission (COSO), the Stock Exchange of Thailand, and the Institute of Certified Accountants and Auditors of Thailand.

The guidelines for internal audit and control cover important issues including the procedures for receiving, paying and lending, creating contingent liability, investing in securities and selling assets.

Reforms on Accounting Practices

To improve the accounting standard, the Accounting Act B.E. 2543 (A.D. 2000) was enacted. This standard was based on the International Accounting Standard (IAS). The law requires all companies operating in Thailand to comply with the new accounting standard. Otherwise, they will be penalized. For listed companies, there are additional penalties imposed by the Securities and Exchange Act.

External Audit

All financial statements of banks must be certified by an external auditor who is approved by the BOT. An external auditor must not be a director, officer, or employee of the commercial bank. In November 2002, the BOT has further specified qualifications of an external auditor, approval criteria, and scope of audit work. A bank must not use the same auditor for more than five years. An external auditor is required to provide an annual report on the efficiency of the bank's internal controls, internal auditors' competency, and unusual lending practices.

Regulations on Lending to/or Investing in Related Parties

Under the regulation, banks are prohibited to lend to insiders who are the executives (directors and senior management) and major shareholders. Insider also includes his immediate family and affiliated companies in which he owns more than 30% of the shares. A bank is allowed to lend to or invest in the companies in which the insiders hold less than 30% of the shares. However, such transactions must not exceed the limits of 5% of the bank's tier 1 capital, 25% of the total liability of such companies, or 50% of such companies' equity, whichever is the lowest.

Furthermore, directors are also prohibited from guaranteeing any debts, accepting, providing aval, and intervening in any bills of which the directors are drawers, makers, or endorsers.

3. Roles of Safety Nets and Prudential Regulation

This section investigates the development of the safety nets since the end of the 1970s until the present. Our focuses are on the deposit insurance system and the way financial authorities handled troubled banks. We argue that the safety nets gave rise to moral hazard. In addition, we investigate the effectiveness of bank supervision by the BOT. We also discuss recent reforms in bank supervision that were implemented by the BOT.

Depositor Protection

Depositor Protection before the 1997 Crisis

The BOT's first attempt to implement a systematic framework of deposit insurance was in 1979 in response to the Raja Finance crisis (Bank of Thailand, 1995; Wesaratchakit, 2001; Satitniramai, 2002).[10] The closure of the company caused a deposit run on other finance companies and the entire financial system experienced a flow-on negative effect. As an immediate measure, the government reimbursed the depositors of Raja Finance with 20% of the principal. Then, the basic principles of the Deposit Insurance Institutions of Thailand Act were drafted and approved by the Cabinet on June 10, 1980. Unfortunately, the Act was blocked by the large banks and finally was withdrawn. The banks strongly opposed two issues: (1) the idea of empowering the BOT to intervene financially distressed banks including dismissing and replacing the executives and (2) the basis of insurance premium calculation (Satitniramai, 2002).

During 1983-1984, another finance company crisis and bank runs occurred. During this period, 20 finance companies were closed down and 25 other finance companies were put in the "life-boat" scheme to be rescued by the BOT. Again, the BOT used an ad hoc measure. To prevent bank runs, the BOT fully reimbursed depositors of the 20 failed companies the face value of their principal, but with no interest.

Meanwhile, many banks were also experiencing difficulties as a result of mismanagement and insider lending. The most serious case was Asia Trust Bank that eventually collapsed in September 1984. The bank was nationalized and merged with the state owned Krung Thai Bank. In 1985-1987, two more banks, First Bangkok Bank and Siam City Bank, were also in distress. The BOT rescued them by providing funding. During 1985-1988, the amount of cash injected into the banking system was about one billion baht a year (Bank of Thailand, 1992). Again, all depositors were fully reimbursed.

By this time, the BOT realized that it needed to establish an explicit deposit insurance system to deal with bank failures. But, it was again blocked by the MOF (Siamwalla, 2001). By law, the BOT is not allowed to grant loans on mortgage of immovable property, or become the owner of immovable property other than its own premises, or to grant unsecured loans. So, in effect, the BOT could not implement measures to rehabilitate financial institutions. Instead of changing the law, the Financial Institutions Development Fund (FIDF), was set up in November 1985. The FIDF operates as a *de facto* department of the BOT. The basic function of the FIDF is to assist restructuring of troubled financial institutions. Its authority includes: (1) providing financial assistance in terms of deposit and low-interest loans to ease liquidity, (2) injecting funds in the form of equity (3) taking over financial institutions and liquidating bad assets before rehabilitating them, (4) transferring good assets and liabilities of insolvent

[10] The Raja Finance was a large finance company that was liquidated due to extending a huge amount of loans to its executives to manipulate the company's share price. The company suffered a severe liquidity crunch when

financial institutions to healthy ones, (5) implementing policies to enhance better management of troubled financial institutions, and administration of the blanket guarantee system since 1997. The FIDF is jointly funded by the financial institutions and the BOT. The current premium is 0.2% of a bank's outstanding deposits.

There was another unsuccessful attempt to introduce an explicit depositor protection system in 1991. A Bill was drafted on the 1981 Deposit Insurance Agency Act and was submitted for parliamentary approval. However, the Bill was withdrawn by the MOF (Bank of Thailand, 1995; Siamwalla, 2001; Wesaratchakit, 2001). Again, financial institutions opposed the idea of the BOT having the authority to supervise and resolve distressed financial institutions.

In summary, until the crisis, Thailand did not have a formal deposit insurance system that would arrange for the systematic exit of financial institutions when they are nonviable. The financial authorities, however, had handled troubled financial institutions on an ad hoc basis. As for depositors, the law did not specify *ex ante* the terms and conditions of how depositors of failed financial institutions would be protected. However, the government had often rescued and provided financial support to troubled banks and generally reimbursed depositors and sometimes creditors as well. So, *de facto* the safety net implied a blanket guarantee (Siamwalla, 2001) that was made official in 1997. As widely recognized, the presence of a blanket guarantee reduces the incentives for insured depositors and creditors to monitor banks as they are fully protected regardless of the outcomes of the investment strategies employed by the bank management.

The Blanket Guarantee since 1997

By the beginning of 1996, many financial institutions were in serious financial trouble. The first intervention by financial authorities began in May 1996 when there was a run on Bangkok Bank of Commerce. The problems escalated in the beginning of 1997. In March 1997, 10 finance companies were ordered to recapitalize. About three months later, in June 1997, another 16 finance companies were suspended, and 8 finance companies were ordered to recapitalize. To prevent runs on these finance companies and other financial institutions, all depositors of these undercapitalized and closed-down companies were reimbursed by the FIDF in the form of 3 to 5-year promissory notes at slightly below the market interest rates. However, bank runs continued as depositors panicked in the face of continuous bank and finance company closures.

On August 5, 1997, another 42 finance companies were suspended. To stop the bank runs, the cabinet issued a blanket guarantee to be implemented through the FIDF on the same day. The resolution specified an explicit *full protection*, in local currency terms, for all depositors and non-subordinated creditors of domestic and foreign financial institutions operating in Thailand. The guarantee applied only to financial institutions that were not closed or ceased

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the stock price dropped following the collapse of the stock exchange index.

making payments. It also covered full principal and full or (under certain conditions) partial interest.

Since the cabinet resolution on the blanket guarantee, the FIDF has made repayments to depositors and creditors of one bank, Bangkok Bank of Commerce and five finance companies (Bank of Thailand, 2000 and 2003). In November 2003, creditors of all financial institutions were excluded from the blanket guarantee. The current blanket guarantee, hence, covered only depositors and those who hold promissory notes issued by financial institutions.

Plans to adopt the System of Limited Deposit Insurance

The blanket guarantee has no repeal date and can be repealed only if a deposit insurance agency is established. As the potential for moral hazards discussed earlier is greater under a blanket guarantee, the government has been working on the design of a limited deposit insurance scheme since 2000 (Wesaratchakit, 2001; Bank of Thailand, 2003). The plan is implemented with technical support from the IMF and the World Bank. In December 2000, a committee was created with the responsibility of establishing a Deposit Insurance Agency (DIA) and outlining the Deposit Insurance Act. The DIA will take over the task of managing deposit insurance from the FIDF and provide a limited deposit guarantee. In addition, the DIA is responsible for setting and collecting insurance premiums, managing the insurance fund, and resolving nonviable financial institutions. The DIA will assume responsibility for resolving the situation once a financial institution is suspended by the BOT. This will minimize the costs of redeeming deposits and reduce the amount of reimbursements to depositors (Wesaratchakit, 2001; Bank of Thailand, 2002 and 2003).

The DIA will cover all financial institutions and the coverage limit will be first set at Baht 50 million (USD 1.17 million) per depositor per financial institution. The limit will be gradually reduced to 20 million baht and then to one million baht per depositor per financial institution. The DIA is designed to protect small depositors of member financial institutions who account for 90% of all depositors in the financial system. Under this plan, guarantees on inter-bank deposits are to be removed within one year after the establishment of the DIA.

To prevent an adverse selection problem, all deposit-taking institutions will be required to be members of the DIA. Deposit-taking institutions include domestic commercial banks, branches and subsidiaries of foreign banks, finance companies, and specialized financial institutions that take deposits.

Regarding the funding, the MOF contributes the initial funding of one billion baht to the DIA. A target level of the fund size is to be determined. The premiums to be paid by each member of the DIA are calculated as a certain percentage of total deposits taken by each member. Currently, it is known that the rate is a flat rate of 0.4%. The DIA's board has the discretion to lower the premiums whenever it is considered appropriate. But this could only happen after the target size of the fund is reached, and the initial contribution by the government is repaid. It is planned that the premium will be set at a flat rate up to the point whereby the risk rating system is adequately developed (Wesaratchakit, 2001).

The FIDF as the Lender-of-Last Resort

The BOT had served as “lender of the last resort” for distressed financial institutions until the establishment of the FIDF in 1985. As discussed in Section 3.1.1, the basic function of the FIDF is to facilitate the rehabilitation of troubled financial institutions. However, the FIDF was severely criticized for being overly generous in its assistance. Instead of charging a higher penalty rate when lending to the troubled banks, the FDIF always charged interest at well below the market rates. Given this fact, many scholars argued that the FIDF functioned as the “lender of the *first* resort” (Siamwalla, 2001; Thanapornpun, 2002).

The FIDF was also severely criticized during the crisis for lacking an overall plan for the development of the financial sector. In addition to bailing out financial institutions that were imprudent with excessive connected lending, the FIDF was extremely generous in extending unlimited funds to finance companies whose assets were in such a dire state that they could never regain the solvency needed to repay the loans (Nukul Commissions, 1998).

The FIDF was also accused of being unable to distinguish between financial institutions that were in trouble and those that were not in trouble. It turned out that many financial institutions that were not in need of assistance manipulated the scheme to their advantage (Siamwalla, 2001; Thanapornpun, 2002). For example, in December 1998, the BOT and the FIDF prosecuted Thai Capital Finance and Securities Company and its four executives for misleading the authorities. Apparently, the company provided fake documents to convince the authorities that it was in financial distress and hence needed financial assistance. The FIDF accepted the claims at face value and provided soft loans to the company six times, from June 30, 1997 to October 3, 1997. The loans added up to 213.9 million baht.

The FIDF’s practice of rescuing troubled banks has implied that the government has never wanted to let a bank fail. The no failure norm or the “too-big-too-fail” norm has created moral hazard problems in the Thai banking system. For insured bank managers, the promise of government assistance provided incentives to shirk and not to prudently manage the risk of their loan assets.

Bank Insolvency Procedure

In Thailand, bank insolvency procedures are specified in the Commercial Banking Act B.E. 2505 (A.D. 1962). The BOT may order a bank to rectify its condition or operation if it is found that the operation of such bank causes damage to the public interest.[11] The BOT may also order a distressed bank to increase or reduce its capital. The BOT also has the power to

[11] However, no description of the condition or operation that causes damage to the public interest is provided in the law. Hence, how to define such condition or operation depends a lot on the judgment of the authorities.

remove the bank's executives. However, the Minister of Finance has the sole power to take over, withdraw the license, and liquidate a bank.

When a distressed bank is placed under the control of the authorities, the executives will be removed and replaced by a Control Committee. The committee is appointed by the Minister and consists of a chairperson and at least two other members. The chairperson will represent the bank. If the committee considers that the distressed bank is able to continue its business operation, the Minister may order the release of the bank. Otherwise, the bank will be liquidated.

Liquidation of a bank is conducted under the provisions of the Civil and Commercial Code relating to the liquidation of a limited liability company. In addition to the transfer of power and duty of the general meeting to the Minister, any expenses and remuneration brought by the control or liquidation of a bank will be paid out from the assets of that bank.

Typically, the intervention is conducted by the three government agencies namely the BOT, the FIDF, and the MOF. A distressed bank would be ordered to increase its capital and to write off losses and provision for bad debt. Then, the government provides soft loans, injects new capital, and installs a new management team. In effect, such bank will be technically nationalized. Subsequently, the bank may be merged with a state-owned bank or resold to strategic partners. Since the 1970s, only two banks (Asia Trust Bank and Bangkok Bank of Commerce) have been liquidated under the Commercial Banking Act B.E. 2505 (A.D. 1962). In both cases, the banks' licenses were withdrawn.

The Strength of Prudential Supervision

In this section, we discuss the strength of the BOT as financial supervisors who rely upon the BOT's independence from politics and influences by commercial bankers. We also address reform measures geared to enhancing the effectiveness of prudential supervision over financial institutions.

The Central Bank Independence

Theoretically, a supervisor is independent if it can be insulated from or is able to resist pressure and influence to modify supervisory practices in order to advance a policy agenda that is at odds with the maintenance of a safe and sound banking system. In the Thai context, the factors that have been considered to undermine supervisory independence include interference by politics and the owners of commercial banks. We review legal aspects in order to understand the relationship between the BOT and politics and commercial bankers.

The BOT has multiple objectives, namely conducting monetary policy, recommending economic policy, acting as banker to the government and financial institutions, providing lender of last resort facilities, supervising financial institutions, managing international reserves, and issuing bank notes. The upside of having multiple objectives is that it facilitates information flow. In particular, having information on the solvency and liquidity of banks in a timely manner is crucial in times of financial crisis (Goodhart and Schoenmaker, 1995). On the other hand, there may be conflicts of interest that can hamper central bank effectiveness and dilute accountability. For example, too loose a monetary policy may have unintended adverse effects on bank earnings and credit quality. In addition, the wider the role of the central bank, the more it could become subject to political pressures, thus threatening its independence (Briault, 1999). Based on these arguments, Thanapornpun (2002) argued that the BOT should not be responsible for bank supervision.

Bank of Thailand versus MOF

The BOT has been governed by the Bank of Thailand Act B.E. 1942 and the Royal Decree regulating the affairs of the Bank of Thailand B.E. (1942). By law, the BOT is under the supervision of the Ministry of Finance. The nomination, appointment, and dismissal of the Governor and the Deputy Governor are done by the King upon the recommendation of the Minister of Finance and then approved by the cabinet. There is no definite term of office for the position of the Governor and the causes for his/her dismissal are not specified in the Act.

The MOF has the authority over the BOT with regard to bank supervision. The BOT is required to obtain approval from the MOF for implementation of major instruments including setting up the legal reserve ratio and the capital adequacy ratio. In effect, the BOT is accountable to the MOF and not to the general public. This institutional design, therefore, leaves the Governor with only one option that is to resign or face dismissal, should conflict arise between the government and the BOT. Indeed, Table 3:1 shows that five out of 19 governors over the past 60 years were dismissed or pressured to resign. The most recent case was the previous Governor, M.R. Chatu Mongol Sonakul, who was relieved of his position as a result of disagreement over interest rate policy with the Prime Minister, Thaksin Shinawatra.

Since 2000 the BOT has been trying to propose amendments to the Act to enhance the independence of the BOT (see Malakul na Ayudhya, 2002). In this proposal, the role of the BOT would be limited to maintaining price stability and the financial system. The Governor would be selected by a nominating committee appointed by the Cabinet. His term would be five years and may be extended only once. The causes for removal would be clearly specified and would be limited to cases of inefficiency. The Court of Directors will also be empowered as a check-and-balance to the Governor. The proposed legislative reform would also empower the BOT as the financial system supervisor. The BOT would be authorized to issue bank licenses, set new supervision rules, and impose penalties on financial institutions without the approval from the MOF.

However, since the draft has to be enacted by the parliament, it is widely thought that the MOF is likely to oppose it in order to maintain its power over the BOT. Perhaps under this environment, the BOT can be independent from political influences only by having integrity, credibility, and capability (Satitniramai, 2002; Thanapornpun, 2002).

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Insert Table 3:1 here

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Bank of Thailand: Challenge against Krung Thai Bank

In this section, we review a rare incidence of the BOT acting as a tough financial supervisor. The saga over at Krung Thai Bank (KTB) is a case in point. In early 2004, the BOT reviewed the loan portfolios of KTB and ordered the bank to reclassify about 46 billion baht ($1.1 billion USD) worth of doubtful loans that had been extended to 12 companies. As a result, a total of 12.3% of its loans would be considered as non-performing as of the end of June, up from 7.7% percent at the end of March. The BOT later singled out KTB for lax lending standards. The Minister of Finance, Somkid Jatusripitak, directed the bank to set up a special committee to review these controversial loans. The committee determined that the acting president Viroj Nualkhair and other top executives were not involved. However the BOT was not convinced, and had maintained its allegations against Viroj and called for him to be held accountable for failing to adequately supervise the bank's lending practices. This prompted the BOT Governor to resist the government's reappointment of Viroj as the president of KTB for a second term on September 9, 2004. At the same time, the BOT also disqualified eight former directors and managers of KTB. The BOT won the first round.

The Minister of Finance, however, lent his full support to Viroj's reinstatement. It was actually the Minister of Finance who appointed Viroj in 2001 and again in September, 2004. Also, KTB has been a key player in Thaksin's strategy to boost domestic growth known as "Thaksinomics." It remains to be seen whether the BOT Governor can remain independent from political interventions.

The Influences of Commercial Bankers on the Bank of Thailand

Satitniramai (2002) argued that the bankers had immense power over the financial supervisory authority during the period 1942-1997. The bankers lobbied the MOF as well as the BOT officials via the powerful Thai Banker Association. The bankers' influence on the BOT had undermined its supervisory role. For example, when the BOT tried to impose the prudential standard capital adequacy ratio in 1962, 1979, and 1992, the bankers negotiated for lower ratios and won every time. In 1992, the Thai Banker Association managed to have the capital adequacy ratio reduced from the original requirement ratio of 8% to 7%, and the second tier capital reduced from the original requirement ratio of 3% to 2%.

In addition, due to opposition by the bankers, the BOT had failed a number of times to institute a comprehensive framework to cope with bank failures (see Section 3.1.1). The BOT obtained the legal power to handle bank failures very gradually. In 1985, the BOT was granted the power to dismiss and replace the executives of failed banks. It was not until October 1997 that the BOT was given the legal power to merge a failed bank with others.

The bankers were so influential that they blocked the BOT from introducing the rule-based free entry policy. From 1966 to 1997, no single new commercial bank license was granted. As a result, the banking industry had long been highly concentrated in the hands of a few influential families.

The Thai Banker Association is likely to be less influential over the BOT after the crisis. The major factor is the tremendous changes in the ownership structure of the commercial banks (see Section 2). The banking industry is no longer controlled by a few influential families.

Reforms of the Financial Institution Supervision Practices

In this section, we review major reforms of the supervisory framework that have been implemented since 1997. Following the study by the World Bank conducted in 1998-1999, the BOT has been implementing the following measures:

(1) Legal reforms. To provide an effective supervisory framework, the BOT reformed the laws by combining the Commercial Banking Act and the Act on the undertaking of Finance Business, Securities Businesses and Credit Foncier Businesses. The new Financial Institutions Act provides a uniform standard of supervisions on all financial institutions and gives the BOT the sole responsibility for financial institution supervision.

(2) Revision of regulatory guidelines to be consistent with the Basel Committee Core Principles for effective supervision. The guidelines focus on risk management, sound management, and transparent, timely and adequate information disclosure.

(3) Consolidated supervision. The BOT is in the process of having enacted the Financial Businesses Act that will empower the BOT to monitor financial institutions on a consolidated basis. The consolidated supervision framework became essential in response to the universal banking business that allows banks to undertake leasing, insurance, securities business via subsidiaries and affiliates.

(4) The establishment of a credit bureau and the enactment of the Credit Bureau Act in November 2002, which became effective in March 2003. The Credit Bureau facilitates information sharing among financial institutions, thereby improving their credit risk management.

(5) The plan to establish a Deposit Insurance Agency (DIA) and clear guidelines for resolving distressed financial institutions. Also important is the implementing of strategies for replacing the blanket guarantee by a limited deposit guarantee. The DIA will also replace the FIDF over the task of administrating deposit insurance.

(6) Restructuring the Supervision Group. The Financial Institutions Policy Board was established to oversee regulatory policies. The Financial Institutions Development Board will promote the standardization of supervisory practices.

The Establishment of the Supervision Group

The Supervision Group, which is responsible for supervising commercial banks and other financial institutions, was reorganized in 2001. The group composes of six departments: planning and development, financial institutions applications and special examination, risk management and information system examination, financial institutions monitoring and analysis, on-site examination 1, and on-site examination 2.

Since 1999, the approach of supervision and examination of banks has become more market based and focused on corporate governance, risk management and internal control. The procedure involves off-site and on-site examination. The off-site examination serves as an integral part of the overall supervision process. The off-site process, which conducts quarterly reports, serves as an early warning system to change and improve the condition of an individual bank.

When serious problems are found, a discussion with the top management of the financial institution is held. The off-site process is integrated with the on-site examination process by participating in the pre-examination phase to develop the scope of on-site examination. In this preliminary analysis, the information obtained from internal and external auditors is also used. To facilitate the on-site examination, the compliance examination is undertaken by the compliance examiners. After the on-site examination, banks are rated according to its aggregate level of risk in relation to its strategic risk, credit risk, market risk, liquidity risk, and operational risk. The frequency of the on-site visit depends on the soundness of banks and rating. Banks with high ratings from 1-4 is subject to an on-site examination once a year. Banks with the lowest rating of 5, however, will be intervened and closely monitored. The working time and the number of examination staff vary with the size of banks. A preliminary analysis prior to commencing an examination takes about 20, 15, or 10 days for respectively large, medium, or small banks. An on-site examination takes about 40, 30, and 20 days for large, medium, and small banks, respectively. The number of examination staff is about 18, 12, or 10 for respectively large, medium, or small banks.

The Supervisory Staff

The BOT established an Examiner School in 1999 to train the supervising staff. The first group of qualified examiners completed their training around the end of 2001. Job rotation within the supervision group is also used for training purposes.

The supervision group of the BOT has been staffed by capable and qualified examiners; and because of the status and its competitive pay system, the BOT has never had problems in recruiting smart people. The BOT has a number of staff holding graduate degrees from well-known foreign and domestic universities. In addition, since the 1960s, the BOT has a scholarship program that provides financial support to promising students and its staff to study at internationally renowned universities.

4. Internal Corporate Governance Mechanisms

Besides safety nets of the financial system and market discipline in the banking sector, internal corporate governance mechanisms are as important in shaping sound corporate governance of banks. Due to the unique characteristics of banks, there should be some different measures to enhance internal governance mechanisms of banks compared to non-financial companies. As for Thai banks, the financial supervisory authorities focused on the effectiveness of the board of directors, the establishment of new committees, the qualifications of directors and top executives, the nomination and compensation of management, the improvement of internal control system and risk management practices, and the quality of information disclosure. So far, all banks have technically met the minimum requirements. Despite this, corporate governance of Thai banks is still lower than the international standard.

In this section, we investigate the effectiveness of internal corporate governance mechanisms focusing on the board of directors system, executive compensation, internal control, and disclosure and transparency. We also evaluate the policy efforts to enhance corporate governance of banks taken since the crisis. We use the information from the annual report of a bank to clarify the characteristics of its board. This source of data allows us to analyze 13 banks that were operating during 2001-2003. In addition, we conducted a survey that was based on 12 banks that were operating in the summer of 2004. Our survey questionnaires included the following five issues: the effectiveness of the board of directors, the executive compensation scheme, the risk management practices, the internal control system, and the disclosure policy.

The questionnaires were responded by an executive director, independent director, officer in charge of executive compensation, officer in charge of risk management, and the corporate secretary of the bank. Out of 12 banks, 11 banks responded.[12] Among the 11 banks, two

[12] Note that we could not get responses from Thai Military Bank and DBS Thai Danu Bank. In September 2004, the two banks merged with the Industrial Finance Corporation of Thailand to become Thai Military Bank.

banks did not answer all the questionnaires. The Bank of Asia was taken over by the United Overseas Bank during the summer 2004 while we were conducting the survey. So, we could not have the questionnaires to be responded by the bank's executive director. Another bank did not respond to the questionnaires on executive compensation.

Effectiveness of the Board of Directors and Other Committees

Board of directors is a widely documented corporate governance mechanism, particularly in an economy where legal investors' protection is relatively weak. For banks in which information asymmetries are greater, effective board of directors is vital for good corporate governance. We evaluate the effectiveness of the banks' board by investigating the characteristics of all the board members including the Chairperson, the CEO, and other members, and how the board functions. We also discuss the role and functions of the board of directors; and analyze the characteristics of board's audit, risk, and nomination committees.

General Characteristics of the Board of Directors

The board characteristics of the Thai commercial banks, their size and composition, can be summarized as follow (Table 4:1).

(1) Board size: The average board size increased from 10.9 in 2001 to 11.9 in 2003, which is larger than the minimum requirement of nine.

(2) The number of independent directors: The average number of independent directors was 3.5, in 2001, and 3.9 in 2002 and 2003, which is higher than the legal requirement of three or one fourth of the total.

(3) The proportion of executive directors: Executive directors accounted for about one-third of the board, which is the maximum number allowed by the regulation.

(4) The incidence of founding family members on the board: In Bank of Ayudhya, Bangkok Bank and Kasikorn Bank, members of the founding families remained as either the Chairperson or the CEO of the banks in all three years.

(5) Foreign directors: The share of foreign directors increased from 16% in 2001 to 19% in 2003 due to increase in foreign ownership. In 2003, around one quarter of the banks had foreign executive directors and about one third of the banks had foreign non-executive directors. Of those surveyed, 31% of the banks had foreign independent directors. In three foreign owned banks, the representatives of the largest shareholder served as the Chairman and CEO. They also held a majority of the board.

(6) Education background: On average, the education level of directors was about bachelor's degree in 2001 and 2002. In 2003, directors had, on average, a master's degree in 2003.

(7) The number of boards a director served on: On average, a director served in more than one board. In 2003, the average number of other *non-listed companies* where a director simultaneously served was 0.57. On average, a director simultaneously served on the boards of 1.65 *listed companies*. So, the board members were not over stretched. The number was significantly lower than the limit of three business groups set by the BOT.

(8) The incidence of the Chairperson and CEO being the same person: In only one bank, Bank of Ayudhya, the founding family and controlling shareholder, has served as both the Chairperson and CEO.

Background of the Chairpersons, CEOs

Table 4:2 shows the background of the Chairpersons and CEOs as of 2003. We find that it is rarely the case that the Chairperson and CEO were former officers of financial supervisory agencies or former politicians. Regarding educational background, the CEOs had, on average, a higher education level than the Chairperson. In the majority of banks, the CEO had a master's degree. Most of the Chairpersons and CEOs had a degree in finance or economics. None had a degree in accounting.

Regarding nationality, there were two banks where both the Chairperson and the CEO were foreigners. Both banks were foreign owned, namely DBS Thai Danu Bank and UOB Radansadin Bank.

Background of Other Directors

Table 4:3 shows the characteristics of board members using the data of 2003. The board members are classified into two groups: independent directors and other directors.

(1) *Independent directors*. The evidence shows that independent directors were predominant financiers, former central bankers, former and current officers of government agencies (non MOF), and academics. Out of 13 banks, three banks had independent directors who were former officers of the BOT. One bank had an independent director who was formerly from the MOF. In four banks, at least one of the independent directors was from a government agency (non MOF). In another five banks, at least one independent director was a former officer of a government agency (non MOF).

Besides the government agencies, we find that in three banks there was at least one independent director from another financial institution. There were professors or researchers acting as independent directors of three banks. There was no single bank in which the independent directors were from the banks' affiliated companies.

Independent directors had educational backgrounds that related to the banking sector. Except in one bank, we find that independent directors have backgrounds in finance or economics.

(2) *Other directors*. Here, we analyze board members who were not independent directors. Insiders were prevalent on the board. On average, there were about 2.1 persons per board who were insiders. We also find that in 12 out of 13 banks, there was at least one director who was an employee of the bank. In addition, there were about 1.9 persons per board who were employees of the banks' affiliates.

We find that there were former officers of the BOT, the MOF, and other government agencies on the boards. Former BOT officers were on the board of two banks, and former MOF officers served on the boards of three banks. In six banks there were former officers of other government agencies besides the BOT and the MOF on the board.

As for state owned banks, we find that the BOT and the MOF had acting officers on the board. In six banks, the current employees of the BOT were on the board. The current employees of the MOF were in the board of four banks. We also find that in four banks there was at least one director who was from government agencies other than the BOT and the MOF.

Regarding the educational background, the board members were highly educated. More than 50% of the board members have a master's degree, and about 8% of the board members have a doctoral degree. The remaining members have a bachelor's degree. About 48% of the board members have a degree in finance, economics, or accounting. About 10% of directors have backgrounds in law.

Concerning nationality, it is not common for Thai banks to have foreign directors. There were six banks in which foreigners served on the board. On average, the share of foreign directors on the board was 23%.

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Insert Table 4:1, Table 4:2, Table 4:3 here

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Committees

In this section, we investigate the characteristics of audit, risk, and nomination and compensation committees. Table 4:4 shows our investigation based on the data of 2003.

(1) The audit committee. The average number of committee members and independent members was 3.3 and 3.1, respectively. So, all banks complied with the rule regarding the number of committee members.

Regarding the background of the members, the Securities and Exchange Commission requires that at least one of the audit committee members should have finance or accounting background. In 12 out of 13 banks, there was at least one committee member with accounting/financing expertise. On average, the number of committee members with this qualification was 2.2. Interestingly, although it is not mandatory that the audit committee be chaired by an independent director, in all banks the Chairperson of the committee was an independent director.

(2) The risk management committee. It should be noted that due to the unavailability of information, we could not cover all the banks. Only seven banks (accounting for 54% of all banks) disclosed the names of the committee members in the annual report, while only five banks (accounting for 39% of the banks) disclosed also the background of the members.

On average, the number of committee members was 8.1, which complied with the BOT rule of at least five. Most of the committee members were the bank's executives from different departments and were not on the board of directors. Out of the seven banks that disclosed the names of the committee members, six banks had their CEO or managing director as the Chairperson of the committee, which was consistent with the suggestion by the BOT.

(3) The nomination and compensation committees. There are 11 banks that set up these committees, accounting for 85% of the banks. All the banks with the nomination committee voluntarily disclosed member information. On average the committee consisted of 3.4 members, which are higher than the legal requirement of 3. All committee members were also on the bank's board. In approximately 64% of the banks with a nomination committee, the Chairperson was an independent director, which complied with the BOT's recommendation.

We find that the average number of committee meetings was 4.56 per year which was more often than the BOT's suggestion of two meetings a year. Note that there were two banks in which the committee had only one meeting in a year.

Regarding the compensation committee, the survey result showed that all banks with the compensation committee disclosed information on the members. In eight banks, the members of the compensation and nomination committees were the same. The average number of compensation committee members was 3.8. The committee members also served as board members. Similar to the nomination committee, in about 64% of the banks that had a compensation committee, an independent director was the Chairperson of the committee. The committee members met, on average 3.78 times a year, which was more often than twice as recommended by the BOT.

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Board Meetings

The BOT has no specific rules regarding the number of board meetings to be held annually. Based on our survey, banks held board meetings quite often. Eight banks (accounting for 73% of the surveyed banks) had at least one board meeting per month. Out of the other three banks, one bank held eight meetings a year and the other two banks held four meetings a year (one meeting every quarter). Overall, the average number of board meetings was 11 per year.

We find that Thai banks had the average attendance rate significantly higher than the legal minimum of 50%. In eight surveyed banks, the attendance rate was 90-100%, while in two banks the rate was 80-90%.

Regarding the board meeting minutes, banks had very detailed minutes. The survey shows that all banks replied that they had very detailed minutes for all the board meetings. With the exception of two banks, directors' positions on the board meeting agenda were also recorded in the minutes.

In general, independent directors replied that they were given chances to discuss corporate matters without being interfered with by the bank's management. In 10 banks, independent directors responded that they had other separate meetings without management several times a year. In the remaining one bank, independent directors had their separate meetings only once or twice a year.

In the bank where the CEO was also the Chairperson, independent directors appeared to be inactive. It was also not common for independent directors to alter the meeting agenda that had been set by the Chairperson. In around 55% of surveyed banks, independent directors had never or rarely done so. In addition, independent directors rarely disapproved the agenda items. Specifically, in 64% of the banks independent directors had *never* disapproved agenda items at a meeting, and in 18% of the banks independent directors *hardly* disapproved the agenda items. There were only two banks where independent directors appeared to show some bravery when they *sometimes* disapproved the agenda items. Overall, our impression was that independent directors did not challenge the management.

The Role of the Board of Directors

The literature suggests that a good board should represent shareholders, both minority and controlling shareholders, and aim to maximize shareholders' wealth. In the banking sector, the board of directors should also consider the security of depositors' investment. The results based on our survey are consistent with this view. In particular, on average, responding *independent directors* ranked that when making corporate decisions, the board should be most accountable to minority shareholders and then depositors. Controlling shareholders were ranked the last one after minority shareholders and depositors. The ranking by responding *executive directors* was slightly different, however. They viewed that the board should be most accountable to depositors, then to the controlling shareholders and the minority shareholders, in that order. On the other hand, all respondents agreed that management was at the bottom of whom the board should be most accountable to.

Moreover, the respondents viewed that directors represented *all* shareholders, and their primary role was to maximize the benefits of *all* shareholders. At the same time, most of them did not agree that directors represented *controlling* shareholders.

All respondents also agreed that directors should consider the interests of *all stakeholders*, including employees and creditors. Moreover, they responded that directors should ensure the bank's safety and soundness even at the sacrifice of the shareholders' interests.

Functions of the Board of Directors

The board of directors is expected to serve various functions. According to the survey, the respondents believed that the board effectively performed the following tasks: formulating long-term strategies, establishing and monitoring the risk management and internal control system, monitoring and assessing the process of business operations, overseeing potential conflicts of interest, ensuring the integrity of the bank's financial reporting, ensuring the qualification of board members, and conducting corporate governance in a transparent manner. However, the board's role in selecting, monitoring and replacing CEO, and reviewing executive and non-executive compensation seemed to be limited. Overall, surveyed directors regarded their board as a forum of *serious* discussion for significant corporate matters. None of the respondents deemed that the board was perfunctory or functioned like a "rubber stamp".

It is necessary for (outside) directors to obtain adequate support in order to perform effective functions. The survey revealed that the banks supplied sufficient information in time to be digested before a board meeting. The banks also provided directors with insurance for any personal liability. However, banks did not quite provide funding for the board to obtain outside professional services and training. More precisely, only three out of 11 responding banks permitted independent directors to acquire the services at the bank's expense and two banks provided substantial mandatory training programs for directors. Nevertheless, all banks assigned a contact person to be responsible for the support of outside directors.

Nomination and Replacement of Top Management and Board Members

State controlled banks have traditionally been influenced by the government in relation to nominating procedure. Specifically, we find that in three out of four state controlled banks, the nomination committee existed and one out of these three banks also had transparent written rules about the selection of outside directors. However, when it came to practice, one half of the surveyed directors from state controlled banks agreed that the government had the strongest voice in the CEO selection or dismissal. The other half viewed that the board/nomination committee was most influential. As for the selection or dismissal of outside directors, all respondents agreed that the government had the most significant impact.

For other banks, the board and controlling shareholders played an important role in nominating the CEO. Among 10 directors responding to the question about this view, six directors indicated that the bank's board had the strongest voice in selecting the CEO, while the other three and one director named controlling shareholders and the government, respectively. Regarding the selection of outside directors, the rules were explicitly written in five out of eight surveyed banks. In practice, 11 out of 13 directors who responded to the question viewed that the board dominated this process.

Although the board appeared to have an influence on nominating the CEO and outside directors, it had virtually no say on dismissing the bank's executives. More precisely, we find that except in one bank, the surveyed banks indicated no case in which the board of directors had ever removed key executives.

Minority shareholders seemed to have an insignificant impact on recommending director candidates. Around 45% of surveyed banks revealed that although minority shareholders could nominate director candidates at a shareholders' meeting, it was rarely done. The other 55% of the banks indicated that minority shareholders were not able to do so. Furthermore, cumulative voting practice was not recognized in 82% of the banks.

Evaluation and Compensation of CEO and Directors

The CEO of the majority of Thai banks was subjected to an official performance evaluation. Around 70% of surveyed banks responded that there was formal procedure and criteria for evaluating the performance of the CEO. Only in 36% of the banks outside directors were not reviewed in the same manner.

Regarding executive compensation, only in seven banks (accounting for 68% of surveyed banks), the board or compensation committee reviewed the CEO compensation. The survey results showed that none of the CEOs and executives was offered stock-based compensation. Also, the CEOs and executives did not hold substantial shares. The only exception was Bank of Ayudhya where the controlling shareholder was the CEO.

To the question whether or not the CEO compensation was related to the bank's performance, we got responses from only eight out of 11 banks accounting for 73% of surveyed banks. These eight banks indicated that there were specific performance objectives. Only five banks, however, answered that the CEO compensation was clearly linked with performance measures. The survey therefore showed that the CEO compensation was somewhat related to the bank's performance.

Regarding the pay to directors, banks did not reward the board members individually. We find that only 36% of surveyed banks paid the directors based on performance of individuals. Similar to the CEO compensation, no banks offered their directors stock-based compensation. Directors held insignificant or no shares in the banks.

In general, directors replied that they were satisfied with the compensation. Ten out of 11 responding *independent directors* were satisfied with the current compensation. However, six respondents did not consider that their compensation gave them adequate financial incentive to maximize the interests of all stakeholders.

Executive directors' responses were different. Although seven out of 10 responding *executive directors* were content with the compensation they had received, almost all of them agreed that they were provided with adequate financial incentive to maximize the interests of shareholders as well as other stakeholders.

Ensuring Internal Control, Disclosure and Transparency

In this section, we evaluate the effectiveness of the internal control system including risk management, external and internal audits, and information disclosure. Internal control system is an important element of internal governance mechanisms, especially in the banking industry where risk exposure is relatively high. Also, because of the opaqueness of bank loan portfolios, high standards of accounting and auditing are necessary for effective risk management.

Internal Control and Risk Management

The survey indicates that in all banks, the board of directors regularly performed the following internal controls: discussing with management about the effectiveness of internal control systems, reviewing the evaluation of internal controls, checking whether concerns expressed by auditors and supervisory authorities on internal controls being addressed by management, and reviewing the appropriateness of the bank's risk limits.

The board and the management team usually received adequate and timely information regarding internal controls. More precisely, all surveyed banks answered that they required regular presentations and performance reports on progress toward strategic goals to the board and/or senior management. Eight banks (accounting for 73% of surveyed banks) considered that the communication from the board to senior management was fast. The remaining three banks considered it to be moderate.

In relation to review of the bank's risk limits, all surveyed banks had a process for reviewing compliance with limits on risk exposures. Banks often required risk exposure reports from the management. On average, the most frequently made reports were of "market risk" exposure. In almost 65% of surveyed banks, the board ultimately approved the strategy and major policies on measuring/managing overall risks.

Regarding *credit risk* management, written credit policies and procedures in all but one surveyed bank covered most of the key items recommended by the Basel Committee on Banking Supervision. Likewise, all banks generally considered an assessment of all of the relevant elements stipulated by the Basel Committee. In addition, we find that in most banks significant loans to related parties needed approval by the board and/or report to the BOT.

As for *market risk* management, all surveyed banks had the top management to directly handle and maintain market risk management standards, reporting process, and internal control system. Similar to credit risk management, all banks adopted policies and procedure for limiting and controlling market risks that covered most of relevant areas suggested by the Basel Accord.

Regarding *operational risk* management, nine banks (accounting for 82% of surveyed banks) had operational risk managed and reported internally as a separate risk category. Banks seemed to prefer simpler but less accurate tools in identifying and assessing operational risks to those that are more accurate and complicated. More precisely, key risk indicators (used by 82% of surveyed banks), self-management or risk-management (73%), risk mapping (64%), and thresholds or limits (64%) were more widely used by the banks than scorecards (36%) and measurement of exposure (46%). However, almost all banks applied operational risk management systems of the Basel Accord.

External and Internal Audits

Qualified external auditors are necessary for banks to maintain reliable internal control systems. In general, we find that all banks complied with the relevant BOT's rules. In relation to external auditing, all banks, aside from the two state controlled banks, used one of the "Big Four" audit firms. The two state controlled banks were audited by the state audit agency, "Office of the Auditor General" which audits state owned enterprises. Regarding accounting standards, all banks had those comparable with the international standards.

All banks had an audit committee to assist the board in overseeing the financial reporting process and internal control system. The survey shows that the audit committee of all but one bank selected or recommended external auditors. The committee also conducted a proper review of external auditors' work. Moreover, the audit committee typically approved the appointment of internal auditors and supervised them as well.

We find that in the majority of the banks, all committee members were outside independent directors; and around 70% of the committee members had finance background. The committee was always chaired by an independent director.

The audit committee held a meeting *at least* once every quarter. The average number of meetings is 8.6 per year. Among the banks, the audit committee in state controlled banks held the meetings most often, which was at least once a month. Minutes were written in all but one surveyed bank.

The banks commonly had written rules governing overall audit functions. Such rules were evident in all but one bank. All surveyed banks also had an internal audit department that reported to the audit committee.

Information Disclosure

We find that in general banks followed the disclosure rules of the BOT. However, there was some important information that was not publicly available. The survey shows that 82% of the banks had a formal disclosure policy on financial condition and performance. All banks disclosed quarterly and annual financial statements in a consolidated basis. The information was disclosed in the annual report and available at the bank's website.

Information on self-dealing (related-party) transactions, major contingent liabilities, substantial changes in the ownership, risk management policies, and director compensation was disclosed in the annual report and the report to the BOT and the SET. Only limited information on those issues was disclosed on the bank's web page. We find that disclosure on risk exposure of Thai banks was inadequate compared with the requirements of the New Basel Capital Accord.

The information on governance structures and policies was included in the annual report and also on the website of four banks. Nevertheless, only 46% of the banks disclosed the extent to which the bank's corporate governance practices conformed to the established standards. The information on the board and top management structures was available in the annual report and the website. The details of the background of directors and senior management were available only in the annual report.

Regarding executive compensation disclosure, all banks basically complied with the requirements of the stock exchange. They disclosed an *aggregate* amount of compensation of all directors and the top 15 executives with the highest pay in the annual report. However, the compensation structure was not specified in details. Only one bank disclosed the individual compensation of the top management and directors. Finally, fees paid to external auditors, advisors and other related parties were disclosed by only around 50% of the banks.

Summary on the Effectiveness of Internal Corporate Governance Mechanisms

The survey results show that Thai banks have introduced various control mechanisms and met the minimum requirements of the supervisory agencies. However, corporate governance practices of Thai banks seem less effective than the international standards.

Regarding the board of directors, management and committees, banks reported full compliance with the regulations. Furthermore, the opinion survey reveals that in general the board appeared to be effective. That being said, the following two issues were reported as potential weaknesses. First, the board's role in nominating and evaluating the CEO performance was rather restricted. Second, directors received limited financial support from banks to obtain outside training and services. Third, stock-based compensation was not used in all banks. Directors and top executives held almost no shares in the banks. Nevertheless, our survey shows that CEO compensation was to some extent related to the bank's performance. Banks appear to have specific performance objectives. All the five banks that responded to our survey indicated that CEO compensation was clearly linked with performance measures.

To enhance the effectiveness of the board of directors, the survey reviews that banks should do the following. First, banks should select better qualified and truly independent directors. Second, they should also promote a boardroom culture that encourages constructive criticism and alternative views. Third, banks should also provide adequate and timely information to directors. Fourth, they should allow board evaluation of CEO performance. In addition, director compensation should be better linked with performance. Lastly, the board should not be dominated by the controlling shareholder.

Regarding internal control, the board of directors and the audit committee were responsible to supervise the internal control system. In addition, the risk management committee was also set up to oversee risk management procedures. Each bank surveyed also had a system to maintain the risk exposure within certain limits. While credit and market risk management practices were quite developed, operational risk management practices seemed to be lower than the international standards.

Regarding public information disclosure, Thai banks have not yet adequately disclosed their major information relative to international standards. Therefore, besides financial statements, other important information namely executive compensation structure, risk exposure, and corporate governance practices should be disclosed in greater details.

In the quest to improve corporate governance of banks in Thailand, the survey shows that financial supervisory agencies, outside/independent directors, and large shareholders featured as the most important entities.

5. Discipline by Market Participants

Market discipline refers to market-based mechanisms that provide a disincentive to banks to engage in moral hazard behavior. In principle, the various economic agents that can exercise market discipline are namely depositors, bondholders, stockholders, and credit rating agencies. The effectiveness of market discipline in monitoring banks depends on the following factors: (1) the extent of the government safety net, (2) the degree to which the bank is financed by uninsured liabilities, (3) the degree of competition among banks and the development of the banking sector, and (4) the extent of the ability to observe bank risk choice. In this section, we discuss the institutional background of the banking industry and evaluate the effectiveness of market discipline in the Thai banking sector.

Background of the Banking Industry

Competition in the product markets is considered to be a powerful force towards improvement in corporate governance. The banking services market should be no exception. This section presents the characteristics of Thai banks regarding bank concentration, profitability, and efficiency. We also investigate the financing structure. The financial data are obtained from the I-SIMS and SETSMART databases produced by the Stock Exchange of Thailand.

Bank Concentration and Competition Structure

First, we examine the market shares classified by bank size based on total assets: large, medium, and small. The ranking has remained the same for the period 1990-2003. Note that the ranking is similar when total deposits are used. Bangkok Bank, KasikornBank, and Krung Thai Bank have been the top three largest banks. Siam Commercial Bank, Bank of Ayudhya, and Thai Military Bank have been the medium size banks. Figure 5:1 indicates that the banking industry has been very concentrated. The top three banks hold about 50% of the total assets and deposits of the banking industry. Bank concentration is even higher in the post crisis period. The fraction of assets held by the top three banks is 49.8% in 1996, and 52.9% and 54% in 2001 and 2003, respectively. The fraction of deposits held by the top three banks is 50.5%, 54.2%, and 54.8%, respectively. The top four to six banks hold only about one-fourth of the total assets and deposits of the banking industry. Combined, the largest six banks hold slightly more than 80% of the total assets and deposits in the post crisis period.

Next, we show market concentration classified by ownership. A bank is classified as being controlled by the following types of shareholders based on whether the largest shareholder owns at least 25% of the outstanding shares: government, family, and foreign investor.[13] Here, the government includes the following government agencies: BOT, MOF, FIDF, and the Thai Army and Air Forces (who were the controlling shareholder of Thai Military Bank until 2002). The “other banks” category includes banks in which the largest shareholder owns less than 25% of the shares. In this sense, the ownership is “widely held”. We categorize the Siam Commercial Bank in this category because its largest shareholder, the Crown Property Bureau, is subjected to the special banking law (see Section 2.1). Since 2001, however, the Crown Property Bureau holds less than 25% of the shares.

Table 5:1 shows that the ownership structure of the banking sector changed tremendously after the crisis. Before the crisis, the ownership of Thai banks was concentrated within a handful of families. Out of fifteen banks, twelve banks were family owned, two banks were government owned and one bank was owned by the Crown Property Bureau. There was no single widely held bank. The family owned banks account for about 61.9% of total assets of the banking industry.

[13] According to the Thai corporate law, a shareholder can vote against any important corporate decisions if he

However, after the crisis, the number of government owned banks and widely held banks increased dramatically, while family owned banks almost disappeared. Due to consolidations of distressed banks, the percentage of bank assets held by the government increases sharply to 42.9% in 2001, but declined to 33.3% in 2003 after some banks were sold to foreign interests. The asset shares of widely held banks increase abruptly. In 2003, five out of thirteen banks were widely held. These banks held about 49.6% of total assets of the banking industry. Foreign banks, however, are relatively small. The three foreign owned banks accounted for about 7.3% of total assets of the banking industry in 2003.

Profitability and Efficiency

We measure bank profitability by the ratio of before tax profits to total assets (ROA). As a measure of bank efficiency, we consider the accounting value of a bank's net interest income over total assets (net interest margin). To account for management quality, we include the ratio of overhead costs to total assets. This variable captures cross-bank different business systems, product mixes, and asset allocations with consequently different cost structures. So, overhead may capture cost inefficiency. We also measure the importance of fee-based services for banks by the ratio of non-interest operating income to total assets.

Table 5:2 shows the statistics breaking down the banks by ownership. We find that widely held banks tend to perform better than government and foreign banks. Specifically, widely held banks have relatively higher ROA, high net interest margins, and smaller overheads, and high non-interest income. For example, in 2003 the average ROA in the five widely held banks is 1.2% while the average ROAs in government banks and foreign banks are -1.5% and -0.1%, respectively.

Table 5:3 shows that the capital ratio as measured by the BIS ratio. It was not until 2001 that all banks have met the BIS capital adequacy ratio of 8.5%. Consistent with the results on the ROA, in 2003, widely held banks had the highest BIS ratio at 15.4%, while the average BIS ratios of government banks and foreign banks are 14.1%, and 12.6%, respectively.

Table 5:4 reviews asset quality measured by the ratio of NPLs to total loans. Government owned banks have the lowest NPLs because a large proportion of their NPLs have been transferred to the TAMC. The average ratio of NPLs to total assets at the government owned banks is 5.9%, 8.0%, and 5.7% in 2001, 2002, and 2003, respectively. In foreign owned banks, the NPL ratio is higher than that of government banks, respectively but is lower than that of other banks. This is because a large fraction of them have been removed from the books before the banks were sold to foreign investors. At widely held banks, the average ratio of NPLs to total loans is 15.4%, 18.2%, and 14.2%, in 2001, 2002, and 2003, respectively.

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owns at least 25% of the outstanding shares. So, with at least 25% of the outstanding shares because in which case there would be no other shareholder who could have enough voting rights of 75% to vote against him.

Liabilities and Equity

Table 5:5 shows that Thai banks rely to a considerable extent on deposits to fund their assets. The mean ratio of deposits to total assets for all banks is 82%, 81.5%, and 81% in 2001, 2002, and 2003, respectively. Foreign banks have lower deposits than other banks. For example, in 2003 the average share of assets funded with deposits in foreign banks is 79.5%. In other banks, however, the mean assets funded with deposits in large banks are greater than 80%.

“Non-deposit liabilities” are by far less important sources of funding. Foreign owned banks rely more substantially on the interbank market relative to other banks. While the shares of assets funded with the interbank for the four foreign banks are about 7-8% in 2001-2003, the ratios of interbank to total assets for other banks are less than 4%.

Banks rely less and less on borrowing which includes subordinated notes, bonds, and convertible bonds, convertible bonds, floating rate notes, and subordinated bonds cum preferred shares. The mean ratio of total borrowing to total assets for all banks is 9.8%, 3.8%, and 3.6% in 2001, 2002, and 2003, respectively. Thai banks have relatively low equity ratio after the crisis. The mean equity ratio for all banks declined significantly from 8.2% in 1996 to 3.8% in 2000. Since 2000, however, the equity ratio has been increasing over time (except for Bank of Asia and DBS Thai Danu Bank). Relatively, widely held banks have higher equity ratio of 9.1% in 2003 which is higher than the mean equity ratio for all banks of 7.2%.

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Insert Figure 5:1, Table 5:1, Table 5:2, Table 5:3, Table 5:4, Table 5:5 here

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The Strength of Market Discipline

Market discipline is likely to be more effective, the lesser the degree of explicit or implicit government guarantees relating to bank liabilities, the deeper and better functioning markets where price and quantity movement convey useful information about the solvency of banks, and the greater the degree of bank disclosure. We investigate the effectiveness of market discipline based on this framework.

We argue that market discipline is less effective in Thailand due to the institutional setting. As argued earlier, until the crisis, Thai banks have been protected by an implicit government guarantee that no bank would be allowed to fail. Market discipline is undermined by this policy as bank stakeholders expect that the government will bail out distressed banks. Market sensitivity is dampened by a blanket guarantee that is applied to all depositors and creditors since 1997. Since the coverage is unlimited, this full protection reduces incentives for depositors and creditors to discipline banks. In addition, as shown above, the banking sector is very concentrated in the top three largest banks.

Furthermore, as discussed above, the ownership of Thai banks is very concentrated. We find that there are eight banks in 2001 and seven banks in 2002 and 2003 in which the largest shareholder holds more than 50% of the shares. Concentrated ownership may contaminate market discipline exercised by other shareholders and other stakeholders since it would be difficult to vote against the controlling shareholders. In this section, we show some evidence to support our argument that monitoring by major stakeholders namely depositors and shareholders are ineffective.

Discipline by Depositors

Theoretically, depositors have an incentive to monitor banks and suppress excessive risk-taking activities since they maintain deposit accounts and depend on banks for settlement transactions. Consequently, they would suffer losses should the banks fail. Both large and small depositors can discipline banks by shifting deposits from risky banks to safer banks. Depositors can also demand higher interest rates from risky banks to compensate the risk. Here, we test whether depositors are sensitive to bank risk and select banks based on risk exposure. If this is the case, deposit growth should be negatively related to bank risk.

We use the BIS ratio as a measure of risk. The banks are classified into two groups: high risk and low risk banks. The cut-off is based on the median value of the BIS in 1997 which is 9.13%. So, here only 13 banks that operated as of the end of 1997 are included in our sample. Banks are classified as “high risk banks” if the BIS ratio is below the median value. Otherwise, they are classified as “low risk banks.” High risk banks are the following seven banks: Krungthai Bank, Siam City Bank, Bangkok Metropolitan Bank, Thai Military Bank, (Standard Chartered) Nakornthon Bank, Bank of Asia (ABN AMRO), and Bank of Ayudhya.

Figure 5:2 plots the deposit growth rate for high risk and low risk banks. Except the crisis period (1997-1998), the growth rate of deposits is quite similar for two groups of banks. This evidence is consistent with the hypothesis that depositors do not discipline banks when they were fully protected. Depositors were extremely sensitive to bank risk only during the crisis in 1997 when they seemed to be panic. Both groups of banks experienced a sharp drop of deposits due to bank runs. Consistent with the literature, deposits at high risk banks, however, declined more than those at low risk banks. However, once the blanket guarantee was implemented, deposits at both groups of banks increased significantly in 1998. The deposits at high risk banks increased more than low risk banks. Apparently, out of the 7 high risk banks, 4 were owned by government agencies or nationalized in 1998. With the blanket guarantee and in addition to the fact that the banks were government owned, depositors at these high risk banks might not be sensitive to risk.

To confirm this finding, we perform a regression analysis relating the growth rate of deposits to the BIS ratio. The advantage of this methodology is that the results are not subjected to the choices of the cut-off of the BIS ratio. Also, we control the effects of bank size, profitability, and ownership. Size is measured by the logarithm of total assets. Bank size captures the government's too-big-too-fail policy. Profitability is measured by the ratio of earning before tax to total assets. Profitability is an inverse measure of risk exposure. We include a dummy variable, *state-owned bank* to capture government owned banks that are least likely to fail. The dummy variable takes the value of one if the largest shareholder is the government, and zero otherwise. To account for the business cycle effect, we include year dummies.

Table 5:6 presents the pooled *OLS* regression results. The sample includes all banks that were operating during 1996-2003. Overall, the results are consistent with Figure 5:2. The estimated coefficients on the BIS ratio are positive but not significant at the conventional levels. The results indicate that depositors do not respond to risk exposures measured by the BIS ratio. We also find that the deposit growth rate is significantly higher at government owned banks than other banks. Interestingly, the estimated coefficient on bank size is not significant. This evidence implies that depositors recognize that they were fully protected by a blanket guarantee regardless of bank size.

In unreported results, we ran regressions to check the robustness of our results. First, to control for the ownership structure effect, we included two ownership dummy variables indicating whether banks were owned by family and foreign investors. Second, we tried another two alternative measures of bank risk namely the NPL ratio and the ratio of earnings before tax to total assets. Third, to account for the possibility that depositors might not immediately react to risk factors, we also used one period lagged the BIS ratio, the NPL, ratio and the ratio of earnings before tax to total assets. Our results remained unchanged.

Next, we investigate whether depositors discipline banks by demanding higher interest rates from unhealthy banks. Figure 5:3 plots the median value of the deposit interest rates paid by low risk and high risk banks. The interest rate spread has been very small, except during the crisis period in which the spread rose significantly. This result indicates that depositors were sensitive to bank risk only when they were not confident about a bank's future.

Discipline by Shareholders

The ability to monitor and discipline banks depends crucially on the existence of deep and well functioning markets where price and quantity movements convey information about the solvency of banks. Table 5:7 shows that the turnover ratio of bank stocks is lower than other stocks in the Stock Exchange of Thailand in all periods except 1998. For example, the turnover ratio of bank stocks is 90.1%, 62.6%, and 123.2% in 2001, 2002, and 2003, respectively. The turnover ratio of other stocks is 171.2%, 200.3%, and 281.2% during the same period. The trading of bank stocks is also thinner compared to that of high income OECD countries where the turnover ratio is 139.4% in 2001 (Levy-Yeyati, Peria, and

Schmukler, 2004). Accordingly, price and quantity movements may not be very sensitive to the underlying fundamentals, and undermining their potential as a market discipline.

We test this issue by analyzing whether bank's stock returns are sensitive to its fundamentals. Bank's fundamentals are measured by three proxies for risk exposure and profitability namely the NPL ratio, the BIS ratio, and the ratio of pre-tax profit to total assets. We expect that the stock market should respond positively to a lower NPL ratio, a higher BIS ratio and profitability. Table 5:8 shows the correlation between stock returns and the three variables. The sample includes all banks from 1990 until 2003 or until the year when the banks were closed down. [14] In general, the stock market did not effectively respond to the information on risk exposures and profitability. The signs of the correlation between stock returns are not always as expected. Also, the correlation coefficients are not large. But, among the three variables, the results show that the stock market responds best to the BIS ratio.

Disciplining by Uninsured Funding

The literature suggests that the effect of market discipline is likely to be stronger, the larger the amount of uninsured funding. Sophisticated investors that hold uninsured subordinated liabilities are likely to have incentives to monitor the banks because their claims are junior to protected liabilities such as bank deposits. Also, if banks have to go to the market to issue debt, the process requires them to reveal information about the banks to debt holders and to supervisors. Since the blanket guarantee on creditors was abandoned in October 2003, we expect that creditors should have more incentive to monitor banks.

As shown in Table 5:5, the mean ratio of total borrowing to total assets of all banks is 9.8%, and 3.6% in 2001 and 2003, respectively. The borrowing has been decreasing over time. Among the banks, the ratio of total borrowing to total assets is highest in widely held banks (about 5.4% in 2003) and lowest in government owned banks. While in 2003, a government owned Siam City Bank has no outstanding borrowing, Krung Thai Bank has a very small portion of borrowing. This evidence suggests that the potential for market discipline by debt holders may be greater for widely held banks.

Credit rating agencies may enhance market discipline. As major rating agencies gain access to information on banks that is not publicly available to investors and they act as intermediaries in the disclosure process, investors would have more information about rated banks. We find that out of 13 banks in 2003, seven banks issued subordinated debt and were rated by Moody's.

[14] We could not include UOB Radanasin Bank because the data on stock returns are not available, and Thanachart Bank because it was established in 2001.

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Insert Table 5:6, Table 5:7, Table 5:8, Figure 5:2, Figure 5:3 here

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6. Summary and Conclusion

The East Asian financial crisis has greatly affected the Thai banking sector. The 15 domestic banks operating before the crisis experienced severe problems of impaired assets at different degrees. The worst cases were the eight banks in which the government intervened: one was closed down, five were nationalized and integrated with other government owned banks, and two were acquired by foreign banks. As for the remaining seven banks, three banks were acquired by foreign banks while the other four banks were recapitalized and underwent massive restructurings.

The crisis also enormously changed the ownership and control structure of Thai banks. Until the crisis, fourteen out of fifteen banks were owned by families that had control over the banks during the past decades. After the crisis, the ownership became much less concentrated and widespread amongst other types of shareholders. Among thirteen domestic banks in 2003, three banks were controlled by the government, three by foreign banks, only one by a family, and the remaining five banks were widely held. The three government-owned banks were relatively large and accounted for about 33% of total assets of the banking sector, while the five widely held banks accounted for around 50% of total assets.

In order to deal with the banking problems and establish a stable financial system, the authorities have implemented a number of measures, including legal reforms and establishing several institutions. Among the immediate measures was the implementation of a formal blanket guarantee in 1997 in order to prevent bank runs. The authorities have also attempted to strengthen prudential regulations. One of the major government undertakings is to introduce the Financial Institutions Business Act that combines the three current acts governing different types of financial institutions. The new Act will encourage financial institutions to become more self-regulated and pave the way for universal banking in Thailand. Moreover, under the new Act, the BOT will have the exclusive supervisory power over all types of financial institutions, rather than sharing the power with the Ministry of Finance.

The financial authorities have introduced numerous measures to strengthen prudential supervision and examination, and to enhance the effectiveness of internal governance mechanisms of banks. To improve bank supervision, the BOT has altered the supervisory policy framework to a risk-based supervision. The BOT restructured its organization and set up the Examiner School. Furthermore, the BOT requires that a bank have a “risk management committee” to oversee the overall risks of the bank. Regarding the efforts to promote corporate governance effectiveness, the focuses are on the composition and characteristics of the board of directors, the fit and proper criteria for management, and the establishment of audit, risk management and other committees to strengthen the internal controls.

To evaluate the strength of internal corporate governance mechanisms of Thai banks, we have launched the questionnaire survey to all domestic commercial banks. There are four sets of the questionnaires including the effectiveness of the board of directors, the executive compensation scheme, the risk management practices, the internal control system, and the disclosure policy. The response rate to the survey is over 90%. Overall, the survey results show that Thai banks have typically fulfilled the basic requirements by the supervisory agencies. But, they have not yet met the international standard.

To bring the corporate governance standards of Thai banks up to international standards, the following measures should be taken into account. First, there should be more independent directors in the board. Also, the BOT should ensure that independent directors are well qualified and truly independent of the bank's controlling or major shareholders. Second, the BOT should demand that banks provide directors with adequate and timely information, as well as sufficient access to professional services and training at the expense of the banks. Third, the CEO nomination and removal process as well as the evaluation process of CEO performance should be formally supervised by the board of directors and/or the nomination and compensation committees. Fourth, the BOT should encourage banks to evaluate director's performance on an individual basis instead of an aggregate basis commonly used by Thai banks. Compensation to CEO and directors may also be made more stock-based. Finally, the supervisory agencies should require more detailed information disclosure on the executive compensation, risk exposure, the extent to which the bank's corporate governance practices conform to the established standards, and transactions with related parties.

We find that market discipline appears to be ineffective in Thailand. The banking industry has *de facto* been operating under an implicit guarantee that no bank would be allowed to fail. In addition, the blanket guarantee that was implanted in 1998 offers full protection to all depositors and to creditors. The cover to creditors, however, was removed in October 2003. This institutional setting undermines market disciplines by all stakeholders. Furthermore, the current concentrated structure of the banking services market might weaken the discipline function by the market. We actually find that depositors are not sensitive to bank risk. They did not appear to move away from risky banks and did not demand higher interest rates except for the crisis period when they were not certain about the safety of their deposits. The stock market, however, is somewhat sensitive to risk exposure.

Our findings suggest that it is important to design a mechanism that prevents moral hazard in the banking industry. The level of deposit and credit protection should be set in such a way that it encourages both investors to select banks based on risk exposure and monitor them. The government should also be aware of restrictions on new entries into the banking sector as it undermines monitoring function provided by competition from rival banks.

The 1997 East Asian crisis has brought about the weaknesses in corporate governance in both financial and corporate sectors, which in turn aggravated the severity of the crisis. Understanding corporate governance of banks and the financial environment may help prevent the occurrence of another economic crisis, or at least minimize adverse impacts of the crisis to the economy.

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Table 1:1

Thai Financial System during 1996-2003

This table presents the component of the Thai financial system for the period 1996-2003. All variables are presented in billion baht. Percentage columns show the variables as percentages of GDP. The data are obtained from the Bank of Thailand and the Stock Exchange of Thailand.

	1996		1997		1998		1999		2000		2001		2002		2003	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
Commercial banks																
Assets	5,536	120.0	7,391	156.2	6,465	139.7	6,172	133.1	6,254	127.0	6,410	124.9	6,466	118.6	6,821	114.9
Domestic banks	n.a.	n.a.	5,690	120.2	5,571	120.4	5,408	116.6	5,478	111.3	5,665	110.4	5,780	106.0	6,122	103.1
Foreign banks	n.a.	n.a.	1,432	30.3	894	19.3	764	16.5	767	15.6	745	14.5	686	12.58	699	11.77
Credits	4,478	97.1	5,967	126.1	5,318	115.0	4,952	106.8	4,114	83.6	3,899	76.0	4,570	83.8	4,749	80.0
Domestic banks	n.a.	n.a.	4,924	104.0	4,622	99.9	4,405	95.0	3,603	73.2	3,419	66.6	4,121	75.6	4,334	73.0
Foreign banks	n.a.	n.a.	1,043	22.0	695	15.0	547	11.8	511	10.4	480	9.4	449	8.2	415	7.0
Deposits	3,876	84.0	4,268	90.2	4,580	99.0	4,608	99.4	4,864	98.8	5,059	98.5	5,187	95.1	5,395	90.8
Domestic banks	n.a.	n.a.	4,083	86.3	4,395	95.0	4,392	94.7	4,630	94.0	4,799	93.5	4,913	90.1	5,114	86.1
Foreign banks	n.a.	n.a.	184	3.9	186	4.0	216	4.7	234	4.8	260	5.1	274	5.0	281	4.7
No. of institutions	29		35		37		34		34		31		31		31	
Domestic banks	15		15		16		13		13		13		13		13	
Foreign banks	14		20		21		21		21		18		18		18	
Finance companies																
Assets	1,768	38.3	616	13.0	502	10.9	245	5.3	253	5.1	280	5.5	254	4.7	310	5.2
Credits	1,368	29.7	491	10.4	400	8.7	148	3.2	133	2.7	153	3.0	147	2.7	196	3.3
Borrowings and deposits	1,440	31.2	504	10.7	437	9.5	178	3.8	182	3.7	204	4.0	179	3.3	217	3.7
No. of institutions	91		35		36		22		21		21		19		18	
Credit Foncier companies																
Assets	9	0.2	7	0.2	7	0.2	5	0.1	5	0.1	6	0.1	6	0.1	2	0.0
Credits	7	0.2	6	0.1	5	0.1	4	0.1	3	0.1	4	0.1	5	0.1	1	0.0
Borrowings	7	0.2	6	0.1	5	0.1	4	0.1	4	0.1	4	0.1	5	0.1	2	0.0
No. of institutions	12		12		12		10		10		9		6		5	
SET Market capitalization	2,560	55.5	1,133	23.9	1,268	27.4	2,193	47.3	1,279	26.0	1,578	31.3	2,047	36.4	4,670	80.7

Table 2:1
The 14 August 1998 Program

This table presents the timetables of implementing the 14 August 1998 measures, regarding the resolution of six banks intervened by the government.

Measures	Date
Bangkok Metropolitan Bank (BMB) and Siam City Bank (SCIB) – privatized	
- After full provisioning, capitalization up to 8.5% of risk-weighted assets.	31 August 1998
- Selection of financial advisors for privatization.	15 September 1998
- Announcement of divestiture modalities for the privatization process.	20 September 1998
- Acceptance of bids and transfer to new investors.	31 December 1998
Bangkok Bank of Commerce (BBC) – transformed into non-bank financial institution (AMC) and wound down	
- BBC's banking license to be restricted from accepting new depositors, extending new credit, entering new foreign exchange operations, and assuming contingent liabilities.	17 August 1998
- The Ministry of Finance (MOF)/The Bank of Thailand (BOT) announced the modalities for Krung Thai Bank (KTB)'s absorption of performing assets, deposits, and other liabilities.	17 August 1998
- Terminate management contract with the Industrial Finance Corporation of Thailand in line with existing collateral arrangements.	31 August 1998
- Transfer of performing assets, deposits and other liabilities to KTB.	30 September 1998
- Banking license revoked and BBC turned into a private AMC.	31 October 1998
- Adoption of plan for effective closure of BBC by 31 December 1999, including with regard to the rationalization of staff and branches, and the deposition of nonperforming assets.	31 October 1998
First Bangkok City Bank (FBCB) – integrated with KTB	
- KTB management to take charge of all FBCB operations.	17 August 1998
- After full provisioning, recapitalization up to 8.5% of risk-weighted assets.	30 September 1998
- MOF/BOT to announce modalities for the integration with KTB.	30 September 1998
- FBCB to be fully integrated with KTB and revocation of license.	31 December 1998
Union Bank of Bangkok (UB) – integrated with Krung Thai Thanakit Finance (KTT)	
- After full provisioning, recapitalization up to 8.5% of risk-weighted assets.	31 August 1998
- Adopt plan for completing UB's integration with KTT by 31 December 1998.	31 October 1998
Laem Thong Bank (LTB) – integrated with Radanasin Bank (RSB)	
- After full provisioning, recapitalization up to 8.5% of risk-weighted assets.	31 August 1998
- Adopt plan for completing LTB's integration with RSB by 31 December 1998.	31 October 1998
- After full provisioning, recapitalization upon the BOT's approval of operational plan.	15 November 1998

Source: Bank of Thailand

Figure 2:1
Outstanding NPLs (Million Baht)

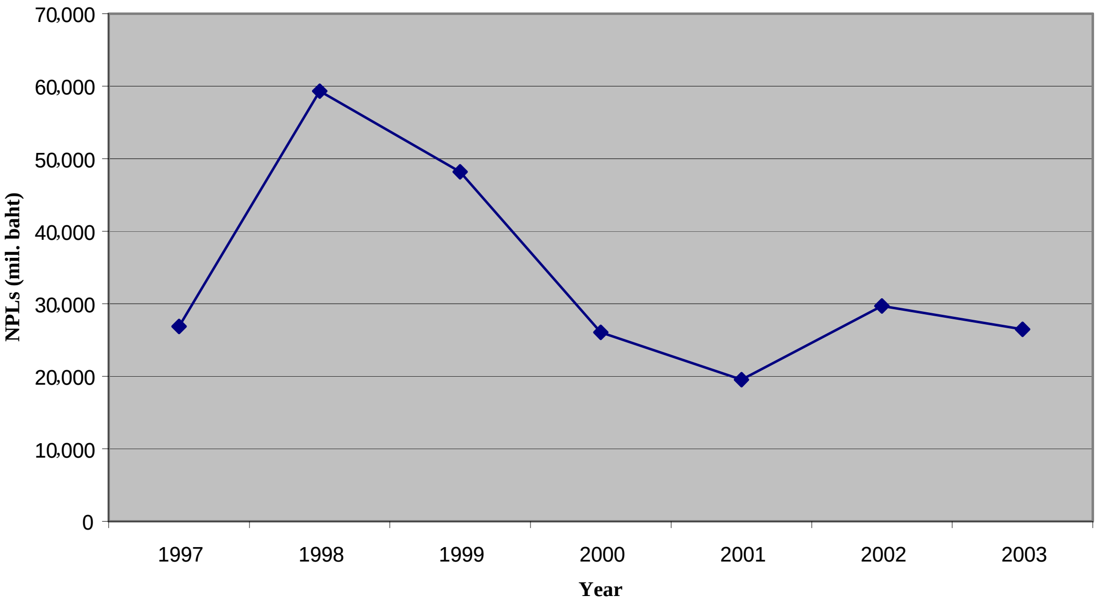

Figure 2:2
NPLs /Total Loans (%)

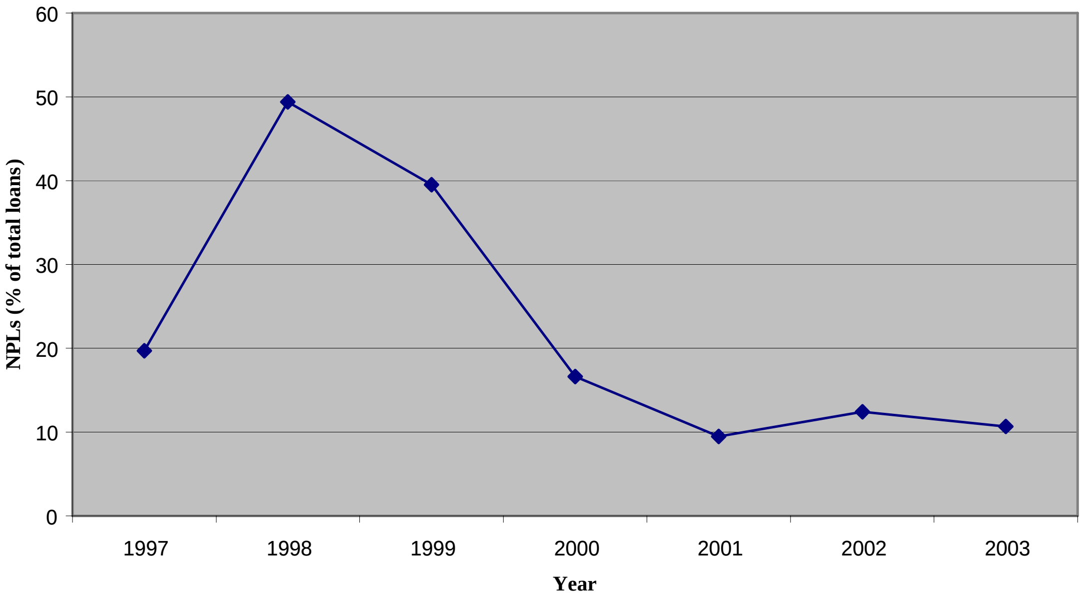

Table 2:2

Identity of Largest Shareholder of Thai Domestic Commercial Banks: 1996-2003

This table presents the name of the largest shareholders of all Thai commercial banks in 1996, 2000, and 2003. The information on the largest shareholder in 1996 and 2000 is obtained from Anuchitworawong, Souma, and Wiwattanakantang (2003).

Commercial Banks (End of 1996)	Commercial Banks (End of 2003)	Largest Shareholder			Resolution during the Crisis
		1996	2000	2003	
Bank of Ayudhya	Bank of Ayudhya	Ratanarak	Ratanarak	Ratanarak	Recapitalized
Bangkok Bank	Bangkok Bank	Sophonpanich	Sophonpanich	HSBC Banks	Recapitalized
Thai Farmers Bank	KasikornBank	Lamsam	Government of Singapore International Corporation	State Street Bank and Trust	Recapitalized through security and bond markets
Siam Commercial Bank	Siam Commercial Bank	Crown Property Bureau	Crown Property Bureau	Crown Property Bureau	Recapitalized through security and bond markets
Thai Military Bank	Thai Military Bank	Army, Navy, Airforce	Army, Navy, Airforce	Army, Navy, Airforce	Recapitalized through security and bond markets
Nakornthon Bank	Standard Chartered Nakornthon Bank	Wang Lee	Standard Chartered Bank	Standard Chartered Bank	Nationalized in 1999, recapitalized and then sold to Standard Chartered Bank in 1999
Bank of Asia	Bank of Asia	Phatraprasith	ABN-AMRO Bank of the Netherlands	ABN-AMRO Bank	Acquired by ABN-AMRO Bank in 1998
Thai Danu Bank	DBS Thai Danu Bank	Tuchinda and Rasanon	Development Bank of Singapore	Development Bank of Singapore	Acquired by Development Bank of Singapore in 1998
Laem Thong Bank	UOB Radanasin Bank	Chansrichawala	-	-	Nationalized and integrated with Radanasin Bank in 1998
-	UOB Radanasin Bank	-	United Overseas Bank	United Overseas Bank	Newly established (assets from Laem Thong Bank) in 1997

Table 2:2

Identity of Largest Shareholder of Thai Domestic Commercial Banks: 1996-2003 (continued)

Commercial Banks (End of 1996)	Commercial Banks (End of 2003)	Largest Shareholder 1996	2000	2003	Resolution during the Crisis
Krungthai Bank	Krungthai Bank	State	State	State	Recapitalized by capital injection by the State (201.57 billion baht in 1998 and 2000) and debt-equity conversion by receiving good loans, deposits and liabilities of BBC and FBCB.
Bangkok Bank of Commerce	Krungthai Bank	Tantipipatpong	-	-	Nationalized in 1996 and closed down in 1998. The performing assets and liabilities were transferred to Krung Thai Bank
First Bangkok City Bank	Krungthai Bank	Siriwattanapakdee	-	-	The government intervened and recapitalized in 1998, then nationalized and integrated with Krung Thai Bank
Siam City Bank	Siam City Bank	Srifuengfung and Mahadamrongkul	State	State	Nationalized in 1998, and recapitalized.
Bangkok Metropolitan Bank	Siam City Bank	Techapaibul and Siriwattanapakdee	State	-	Intervened in 1997 and nationalized in 1998, then integrated with Siam City Bank in 2002
Union Bank of Bangkok	Bank Thai	Cholvijarn	-	-	Nationalized and integrated with Krung Thai Thanakit Finance in 1998
-	Bank Thai	-	State	State	Newly established in 1998. The assets were from the Union Bank of Bangkok, Krung Thai Thanakit Finance, and 12 closed down finance companies.
-	Thanachart Bank	-	-	Morgan Stanley & Co	New license granted to Ekachart Finance in 2001

Table 2:3

Thai Domestic Commercial Banks Classified by Types of the Largest Shareholder

This table presents the number of banks according to the type of their largest shareholder, as well as the percentage to total number of banks for each type of largest shareholder.

Type of Largest Shareholder	**Number of Banks**							
	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Family	12	10	5	2	2	1	1	1
Crown Property Bureau	1	2	1	1	1	1	1	1
State	2	3	5	4	5	5	4	4
Foreign investor	0	0	1	5	5	6	7	7
Total number of banks	15	15	12	12	13	13	13	13

Table 2:4

Voting Rights and Cash-Flow Rights Held by the Largest Shareholder of Thai Commercial Banks

The table presents the percentage of voting rights (VR) and cash-flow rights (CR) held by the largest shareholder classified by types of largest shareholders for the period 1996-2003. The data of 1996-2000 is obtained from Anuchitworawong, Souma, and Wiwattanakantang (2003).

Type of Largest Shareholder		**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Family	VR	23.2	25.7	29.8	29.7	14.9	27.7	33.5	26.6
	CR	18.7	21.9	23.8	22.3	10.7	20.0	24.8	18.7
Crown Property Bureau	VR	34.6	22.5	34.9	34.9	25.1	20.8	14.8	12.2
	CR	31.6	17.9	29.5	29.7	23.4	20.8	14.8	12.2
State	VR	47.8	55.0	82.8	84.4	86.7	78.0	70.2	65.0
	CR	47.4	54.1	82.8	84.4	86.7	78.0	69.1	64.0
Foreign investor	VR	0.0	0.0	9.4	57.8	57.3	49.0	42.7	43.5
	CR	0.0	0.0	9.4	57.8	57.3	49.0	42.6	43.5
Average	VR	27.3	31.1	50.6	60.1	59.6	56.4	48.3	46.4
	CR	23.3	27.8	47.7	58.4	58.8	55.8	47.3	45.5

Table 3:1

Resignations and Dismissals of the Governors of the Bank of Thailand during 1942-2000

The information is complied from Satitniramai (2002) and the website of the Bank of Thailand at http://www.bot.or.th/bothomepage/ BankAtWork/AboutBOT/ Organize/ListOfGovernors_E.htm.

Name	**Resigned/ Dismissed**	**Reasons/Causes**	**Duration of Office**
H.H.Prince Vivadhanajaya	Resigned	Protested the government's method of selling gold reserves	Nov. 1942-Oct. 1946
Serm Winitchaikul	Resigned	Personal reasons	Oct. 1946-Nov. 1947
Leng Srisomwongse	Resigned	Personal reasons	Nov. 1947-Sept. 1948
M.C. Chaiyand Wiwatthanachai	Resigned	Personal reasons	Sept.–Dec. 1948
Leng Srisomwongse	Resigned	Personal reasons	Dec. 1948-Aug. 1949
M.L. Dej Snitwongse	Resigned	Protested the government's plan to revalue the Baht	Aug. 1949-Feb 1952
Serm Winitchaikul	Resigned	Personal reasons	Mar. 1952-July 1955
Kasem Sriphayak	Resigned	Took responsibility for a crime of fraud committed by a BOT staff	July 1955-July 1958
Chote Kunakasem	Dismissed	Allegation of corrupt conduct when changing banknote printing company	July 1958-May 1959
Puey Ungphakorn	Resigned	Personal reasons	June 1959-Aug. 1971
Bhisudhidhi Nimmanhaemindahaemin	Resigned	Allegation of corrupt conduct regarding the construction contract of the BOT new Headquarters	Aug. 1971-May 1975
Snoh Unakul	Resigned	Bad health	May 1975-Nov. 1979
Nukul Prachuabmoh	Dismissed	Disagreement with the Finance Minister over the currency devaluation on Sept. 13, 1984	Nov. 1979-Sept 1984
Kamchorn Sathirakul	Dismissed	Disagreement with the Finance Minister over the interest rate reduction policy	Sept. 1984-Mar1990
Chavalit Thanachanan	Resigned	Reached the BOT's official retirement age	Mar.-Sept. 1990
Vijit Supinit	Pressured to resign	Mismanagement that led to the collapse of the Bangkok Bank of Commerce	Oct. 1990-July 1996
Rerngchai Marakanond	Pressured to resign	Mismanagement of the foreign exchange regime that led to the economic crisis	July 1996-July 1997
Chaiyawat Wibulswasdi	Pressured to resign	As above	July 1997-May 1998
M.R. Chatu Mongol Sonakul	Dismissed	Disagreement with the Prime Minister on the interest rate policy	May 1998-May 2001

Table 4:1

Board of directors: Characteristics

This table presents the characteristics of banks' board of directors during 2001-2003. Education of board members is a dummy variable taking value of 0 if a director holds a certificate lower than Bachelor Degree, 1 if holds Bachelor Degree, 2 if holds Master Degree, and 3 if holds Doctoral Degree. Finance/Banking background of board members is a dummy variable taking value of 1 if a director has some background in the finance or banking area, and 0 otherwise.

Board characteristics	**2001**	**2002**	**2003**
Number of banks surveyed	13	13	13
Number of board members	10.9	11.5	11.9
Number of executive directors	3.7	3.7	3.9
Number of non-executive directors	3.6	3.9	4.1
Number of independent directors	3.5	4.0	3.9
% of banks that have founding family directors	23.1	23.1	23.1
% of founding family directors on board	4.8	4.7	4.5
% of banks that have a founding family member as Chairperson/CEO	23.1	23.1	23.1
% of banks that have foreign directors	46.2	46.2	46.2
% of foreign directors on board	16.3	18.9	19.3
% of banks that have a foreigner as Chairperson/CEO	15.4	23.1	23.1
% of banks that have a foreigner as an executive director	30.9	30.8	23.1
% of banks that have a foreigner as a non-executive director	30.8	30.8	38.4
% of banks that have a foreigner as an independent director	38.5	30.8	30.8
Age of board members	56.6	57.7	57.8
Education of board members	1.7	1.7	2.2
Finance/Banking background of board members	0.8	0.8	0.8
Number of other listed companies that a bank's directors sit on board	0.5	0.6	0.6
Number of unlisted companies that a bank's directors sit on board	1.1	1.2	1.7

Table 4:2

Chairperson and CEO: Characteristics

This table presents the characteristics of banks' Chairperson and CEO as of 2003. The figures the "Chairperson" and "CEO" columns show the number of banks in which the Chairperson and the CEO possess the specified characteristics, respectively. The total number of banks operating in 2003 is 13.

Characteristics	**The Chairperson**	**The CEO**
Family member of controlling shareholder	1	1
Former officer of the Bank of Thailand, Ministry of Finance, or other financial supervisory agency	1	1
Former elected or non-elected politician	2	0
Having a final BA degree	6	4
Having a final MA degree	5	8
Having a Ph. D degree	1	1
Having background in finance or economics	10	12
Having background in accounting	0	0
Having background in law	0	1
Female	0	4
Foreigner	2	2

Table 4:3

Board of Directors: Independent versus Other Directors

This table presents the characteristics of banks' board of directors classified into independent and other directors as of 2003. Other directors include all non-independent directors. Figures in "Share of Directors" columns are the average percentage of directors who possess the specified characteristics in a bank's board. Figures in "No. of Banks" columns are the number of banks where a director with the specified characteristic sits in the board. The total number of banks operating in 2003 is 13. "Former elected or non-elected politicians" include cabinet members.

Board characteristics	**Independent Directors**		**Other Directors**	
	Share of Directors (%)	No. of Banks	Share of Directors (%)	No. of Banks
Family members of controlling shareholder	n.a.	n.a.	8.0	3
Officers of the Bank of Thailand	0.0	0	8.1	6
Former officers of the Bank of Thailand	17.9	3	1.9	2
Officers of the Ministry of Finance	0.0	0	6.6	4
Former officers of the Ministry of Finance	2.6	1	3.3	3
Officers of other financial supervisory agency	0.0	0	0.0	0
Former officers of other financial supervisory agency	0.0	0	0.0	0
Officers of other government agencies	14.1	4	10.3	4
Former officers of other government agencies	10.1	5	6.1	6
Former elected or non-elected politicians	3.5	2	4.0	3
Bank employees	n.a.	n.a.	26.4	12
Employees of the bank's affiliated companies	0.0	0	10.2	6
Employees of other financial institutions	6.0	3	26.3	6
University professors or researchers	7.3	3	2.4	2
Members with a final BA degree	34.6	11	39.7	13
Members with a final MA degree	34.6	10	53.8	12
Members with a Ph. D degree	25.7	9	8.5	7
Members with background in finance or economics	39.1	12	33.0	13
Members with background in accounting	14.2	5	14.5	8
Members with background in law	11.4	6	9.9	8
Female members	13.5	4	15.3	7
Foreigners	9.1	4	22.7	6

Table 4:4

Board Committees: Characteristics

This table presents the existence and the composition of committees that are either required or recommended by the Bank of Thailand. The information is as of 2003. The total number of banks operating in 2003 is 13.

	Audit Committee	**Nomination Committee**	**Compensation Committee**	**Risk Management Committee**
% of banks where the committee exists	100.0	84.6	84.6	100.0
Number of total members	3.25	2.58	3.50	8.13
Number of independent directors	3.08	1.17	1.42	0.00
% of banks where the committee is chaired by independent director	100.0	63.6	63.6	0.0

Figure 5:1

Concentration of the Banking Sector

This figure shows the percentage of total assets held by the top 1-3, top 4-6, and the rest banks.

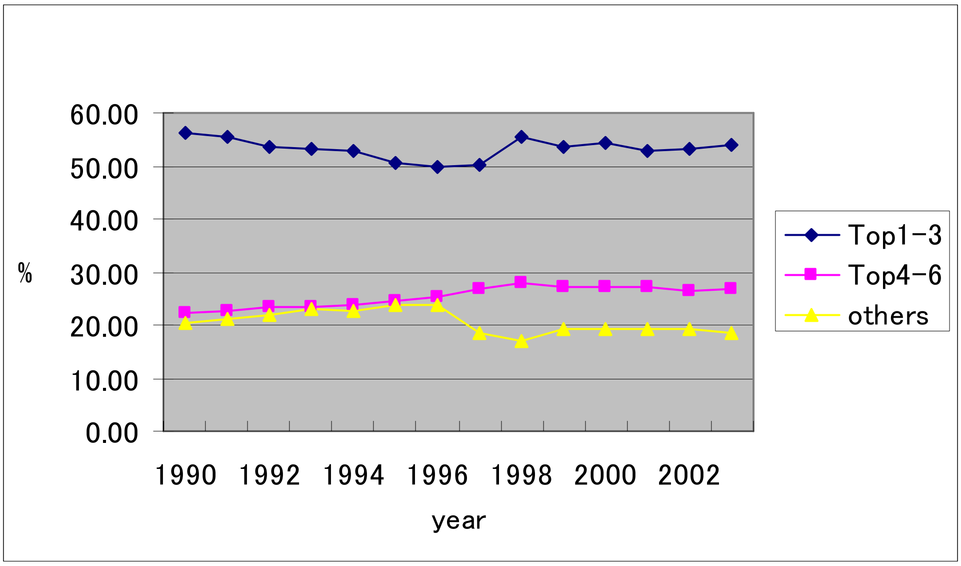

Table 5:1

Total Assets Classified by Ownership

This table shows total assets held by banks classified by ownership. A bank is classified as controlled by the government, a family, and foreign investors if these shareholders hold at least 25% of the shares outstanding. Otherwise, the banks are classified as “others.” Note that in 1996, the bank that falls into the “other banks” category is the Siam Commercial Bank. Its largest shareholder is the Crown Property Bureau which is subjected to special law.

	1996		**2001**		**2002**		**2003**	
Type of control	No. of Banks	% of Total Assets	No. of Banks	% of Total Assets	No. of Banks	% of Total Assets	No. of Banks	% of Total Assets
Government banks	2	25.1	5	42.9	4	43.9	3	33.3
Family banks	12	61.9	1	9.0	1	9.3	1	9.9
Foreign owned banks	0	0.0	4	7.8	4	7.5	4	7.3
Other banks	1	13.0	3	40.3	4	39.3	5	49.6
Total	15	100.0	13	100.0	13	100.0	13	100.0

Table 5:2 **Profitability**

Bank		ROA (%)			Net Interest Margin (%)			Non-Interest Income/Assets (%)			Overhead Costs/Assets (%)		
		2001	**2002**	**2003**	**2001**	**2002**	**2003**	**2001**	**2002**	**2003**	**2001**	**2002**	**2003**
Government banks	Krungthai Bank	-0.45	0.76	0.77	1.99	1.86	2.00	0.75	0.78	0.71	2.16	1.71	1.58
	Thai Military Bank	0.19	-0.04		1.24	1.20		0.98	0.87		1.71	1.02	
	Bangkok Metropolitan Bank	-2.28			0.42			0.66					
	Siam City Bank	-2.40	0.70	-3.70	0.67	0.89	1.96	0.01	1.12	1.04	2.09	1.65	2.87
	Bank Thai	0.42	0.18	-1.52	-0.28	1.55	0.82	2.76	1.09	0.62	2.12	1.84	2.30
	Mean	-0.90	0.40	-1.48	0.81	1.38	1.59	1.03	0.97	0.79	2.02	1.56	2.25
Family bank	Bank of Ayudhya	-0.60	0.45	0.60	1.16	1.48	1.64	0.62	0.96	1.49	2.02	1.75	1.74
Foreign banks	Bank of Asia (ABN AMRO)	-2.40	-1.88	1.08	2.07	2.26	2.26	1.10	1.53	1.53	2.71	2.71	2.54
	DBS Thai Danu Bank	0.17	-0.38	-1.98	2.25	1.58	2.45	0.66	1.54	1.03	2.10	2.78	1.98
	Standard Chartered Nakornthon Bank	-1.05	0.71	1.17	2.84	4.84	5.27	1.59	4.20	1.69	4.00	4.19	4.10
	UOB Radanasin Bank	-1.22	0.29	0.15	0.36	2.41	2.87	1.49	0.89	1.04	2.59	2.13	2.62
	Mean	-1.00	-0.07	-0.08	1.58	2.32	2.68	1.08	1.68	1.26	2.57	2.52	2.54
Widely held banks	Bangkok Bank	0.52	0.50	0.84	1.90	1.80	1.80	0.98	1.21	1.62	1.82	1.99	1.60
	KasikornBank	0.22	0.88	1.81	2.27	2.45	2.38	1.06	1.05	1.67	2.54	2.11	1.74
	Siam Commercial Bank	0.08	-1.85	1.71	2.27	2.64	2.62	1.14	1.57	1.50	1.92	2.21	1.97
	Thai Military Bank			0.82			1.86			1.33			1.49
	Thanachart Bank		0.77	0.72		1.97	1.95		0.50	1.10		0.92	1.43
	Mean	0.27	0.08	1.18	2.15	2.21	2.12	1.06	1.08	1.45	2.09	1.81	1.64
All banks	Mean	0.63	-0.68	0.19	2.73	1.38	2.31	0.90	1.06	1.26	2.32	2.06	2.15

Table 5:3

BIS Capital Adequacy Ratio (%)

	Bank	1998	2001	2002	2003
Government banks	Krungthai Bank	11.3	12.7	14.3	17.5
	Thai Military Bank	10.2	12.7	15.5	
	Bangkok Metropolitan Bank	1.0			
	Siam City Bank	5.8	16.2	11.3	10.6
	Bank Thai		21.5	20.9	14.2
	Radanasin Bank	16.8			
	Mean	9.0	15.8	15.5	14.1
Family banks	Bank of Ayudhya	10.2	11.0	10.8	13.9
	Nakornthon Bank	2.5			
	Mean	7.4	11.0	10.8	13.9
Foreign banks	Bank of Asia (ABN AMRO)		10.9	13.4	13.3
	DBS Thai Danu Bank	9.2	12.4	12.6	11.0
	Standard Chartered Nakornthon Bank		10.9	11.3	13.2
	UOB Radanasin Bank		12.8	14.2	12.8
	Mean	6.5	11.8	12.9	12.6
Other banks	Bangkok Bank	13.4	11.3	11.5	15.9
	KasikornBank	10.7	15.7	12.6	9.5
	Siam Commercial Bank	9.6	16.6	14.0	12.9
	Thai Military Bank				11.6
	Thanachart Bank			32.3	26.9
	Mean	10.7	14.5	17.6	15.4
All banks	Mean	9.2	13.7	15.1	14.1

Table 5:4

Non-Performing Loans/Total Loans (%)

	Bank	**1998**	**2001**	**2002**	**2003**
Government banks	Krungthai Bank	45.57	14.71	25.90	24.66
	Thai Military Bank	31.13	12.28	14.25	
	Bangkok Metropolitan Bank	72.05			
	Siam City Bank	61.73	0.07	0.16	2.66
	Bank Thai	65.58	3.19	6.15	6.34
	Radanasin Bank	69.10			
	Mean	57.53	7.56	11.62	11.22
Family banks	Bank of Ayudhya	36.11	16.58	19.82	15.07
	Nakornthon Bank	40.88			
	Mean	38.50	16.58	19.82	15.07
Foreign banks	Bank of Asia (ABN AMRO)	38.23	18.29	22.21	19.14
	DBS Thai Danu Bank	53.80	5.87	8.94	10.46
	Standard Chartered Nakornthon Bank		2.11	2.64	2.76
	UOB Radanasin Bank		0.85	2.64	3.66
	Mean	46.02	6.78	9.11	9.01
Other banks	Bangkok Bank	45.57	14.71	25.90	24.66
	KasikornBank	42.00	13.10	18.46	12.84
	Siam Commercial Bank	34.20	18.50	24.20	17.51
	Thai Military Bank				9.89
	Thanachart Bank			4.40	5.83
	Mean	40.59	15.44	18.24	14.15
All banks	Mean	49.41	9.48	12.40	10.68

Table 5:5

Structure of Bank Fund: Liabilities and Equity

	Bank	Deposits/ Total assets (%)		Total borrowing/ Total assets (%)		Interbank/ Total assets (%)		Equity/ Total assets (%)	
		2001	2003	2001	2003	2001	2003	2001	2003
Government banks	Krungthai Bank	88.73	88.62	0.00	0.00	3.50	3.08	6.50	6.61
	Thai Military Bank	82.02		7.52		4.52		3.71	
	Bangkok Metropolitan Bank	91.28		8.12		1.56		5.20	
	Siam City Bank	88.02	84.98	1.62	0.00	2.34	3.45	6.25	7.25
	Bank Thai	62.10	76.33	2.12	1.30	13.35	7.57	4.24	2.60
	Mean	82.43	83.31	3.88	0.43	5.06	4.70	5.18	5.48
Family bank	Bank of Ayudhya	84.73	81.15	8.66	5.53	1.41	3.24	3.42	5.50
Foreign banks	Bank of Asia (ABN AMRO)	87.64	83.27	3.09	2.88	1.87	2.38	5.43	8.56
	DBS Thai Danu Bank	77.93	80.67	11.28	7.98	7.24	5.51	4.22	2.85
	Standard Chartered Nakornthon Bank	82.45	74.83	0.00	0.00	8.99	15.73	4.56	7.03
	UOB Radanasin Bank	76.54	77.49	0.00	0.00	15.66	13.05	4.97	7.39
	Mean	81.86	79.48	4.61	3.28	7.04	7.98	4.79	6.46
Widely held banks	Bangkok Bank	86.20	82.39	6.27	5.69	1.91	2.32	3.45	7.52
	KasikornBank	85.79	83.39	6.29	7.29	1.78	0.86	3.49	5.94
	Siam Commercial Bank	83.81	82.06	3.58	3.27	1.58	1.41	8.57	10.26
	Thai Military Bank		86.52		1.92		3.70		6.94
	Thanachart Bank		71.53		8.82		2.20		15.03
	Mean	85.26	81.18	5.38	5.40	1.76	2.10	5.17	9.14
All banks	Mean	82.86	81.81	9.81	3.62	5.18	5.10	4.57	7.19

Figure 5: 2

Bank Risk and Deposit Growth Rate

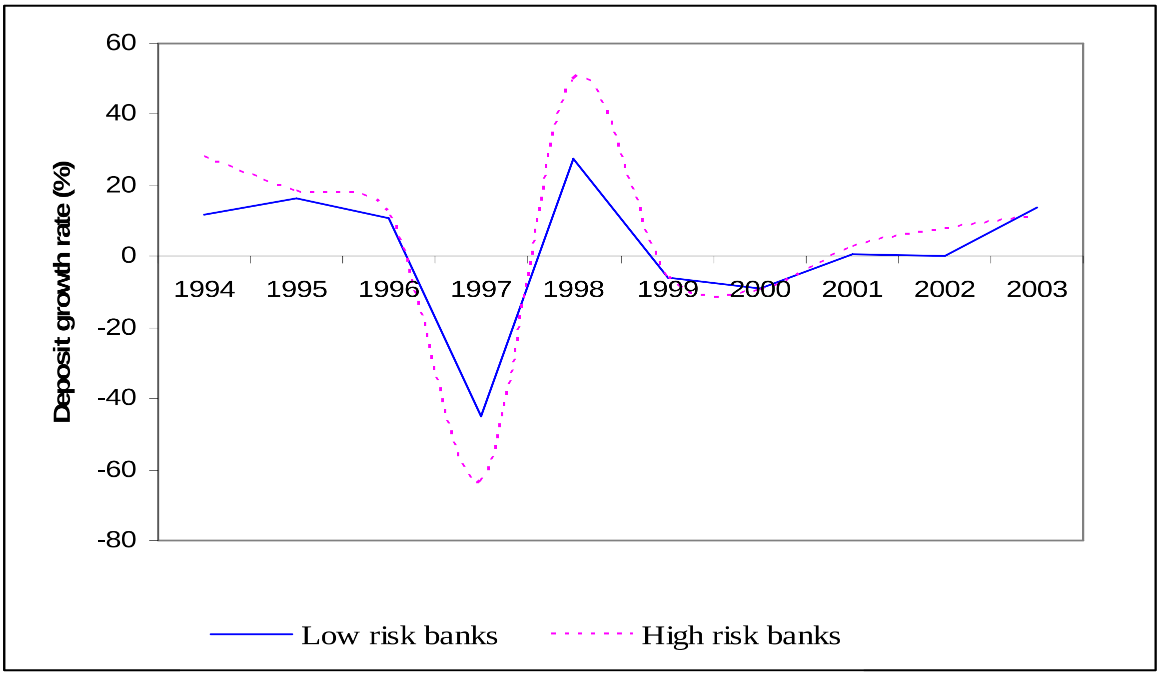

Figure 5:3
Bank Risk and Deposit Interest Rates (%)

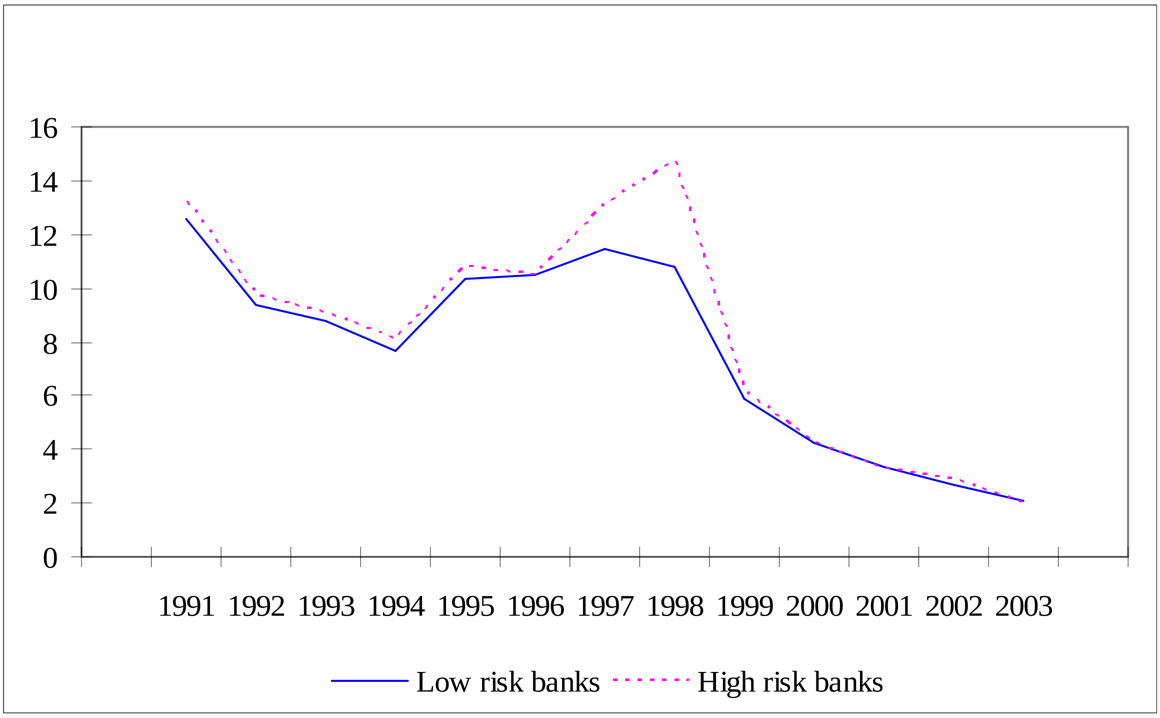

Table 5:6

Regression of Deposit Growth Rate

This table presents the pooled *OLS* regression results. The independent variable is deposit growth rate. *State-owned bank* is a dummy variable which is taken the value of one if the largest shareholder is the government, and zero otherwise. The sample includes all banks that were operating during 1996-2003. ****** indicates statistical significant at the 5% level.

	(1)
BIS capital adequacy ratio	0.160 (0.76)
Earning before tax/ total assets	0.135 (0.40)
Log of total assets	0.302 (0.22)
State-owned bank	7.268**(2.29)
Constant	7.105 (0.40)
Year dummies	Yes
F-statistic	3.55
Adj R-squared	0.2173
Number of sample banks	102

Table 5:7

Turnover Ratio of Bank Stocks

This table shows turnover ratio (%) of stocks of banks and firms traded in the Stock Exchange of Thailand during 2001-2003. The data are obtained from the Stock Exchange of Thailand.

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Bank stocks: % of market capitalization	25.17	20.34	23.94	26.25	21.58	19.10	15.91	15.99	15.12
Turnover ratio - banking sector	1.94	43.85	132.98	59.77	46.29	90.13	62.57	123.20	96.29
Turnover ratio - all sectors	2.00	44.33	100.38	119.05	68.95	171.17	200.33	281.22	177.06

Table 5:8

Correlation of Stock Returns and Three Variables

The sample includes all banks from 1990 until 2003 or until the year when the banks were closed down.

	NPL ratio	**BIS ratio**	**Pre-tax profit/total assets**
Bank of Ayudhya	-0.24	0.70	0.06
Bangkok Bank	-0.06	0.67	0.21
Bank of Asia	0.46	-0.13	-0.08
Bankthai	-0.25	0.38	0.35
DBS Thai Danu Bank	0.75	-0.62	0.04
Kasikorn Bank	-0.27	0.77	0.26
Krung Thai Bank	0.24	-0.18	-0.04
Siam Commercial Bank	0.11	0.40	-0.32
Siam City Bank	-0.33	0.25	0.13
Standard Chartered Nakornthon Bank	-0.42	0.58	0.24
Thai Military Bank	0.17	-0.02	-0.04
Bangkok Metropolitan Bank	0.10	-0.03	0.17
Bangkok Bank of Commerce	n.a.	n.a.	0.53
First Bangkok City Bank	n.a.	n.a.	0.50
Laemthong Bank	n.a.	n.a.	0.24
Union Bank of Bangkok	n.a.	n.a.	0.31