

The Evolution of Corporate Governance in Banking Industry of Thailand:
From the 1997 Asian Crisis to the 2008 Global Credit Crisis

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Abstract

Corporate governance (CG) in banking industry of Thailand has evolved significantly after the 1997 Asia Crisis. The international standard such as OECD and BIS guidelines has been closely followed. Bank of Thailand (BoT) has continuously updated its regulation and best practice advice to reflect the changing financial environment. The new Financial Institutions Business Act was enacted and became effective on Aug 3, 08. The Act that standardizes the different regulations governing commercial banks gives BoT an exclusive supervisory power over all types of financial institutions.

In the wake of the 2008 Global Credit Crisis, some foods for thought are given and discussed for further improvement. Ownership structure does matter. Thai banking characteristics and local environment should be officially recognized. Its practical implication is a need to apply Western CG standards onto local context with a clear strategic direction. Next a trade-off between micro and macro prudence is examined with one example cited. Finally, credit extension cycle and a need for more counter cyclical measures are discussed to improve stability and safety.

Keywords: Corporate Governance, Banking, Thailand, Financial Crises, Agency Problem

JEL: G01, G21, G28, G32, G34

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I. Introduction

Corporate governance (CG) in Banking Industry of Thailand has changed significantly after the 1997 Asian Crisis. In contrast to the drastic change of the Sarbanes-Oxley Act in US, the scope and speed of Thai CG process is not revolutionary, but evolutionary. Accountability, responsibility, disclosure, equitable treatment, transparency, vision and ethics are among the fine issues for the reform efforts from different institutions and regulators. The evolution of CG for Thai banks is quite an interesting success in sense of leap-and-bound process and progress in tune with international development. Its prognosis in the face of the 2008 global credit crisis may give more lights for further improvement.

Many cite poor CG as one of the primary causes of the 1997 banking crisis in Thailand. Siamwalla (2001) asserted that weak CG and un-prudent control were thought to be the most important factors that caused the debacle. The negligent CG lead to over-investment, over-borrowing and reliance on banking lending as claimed by Piman Limpaphayom and J Thomas Connelly (LC 2004). Inappropriate CG allowed banks to lend in unviable projects with overvalued collateral and connection as evidenced by Charumilind Chutathong, Raja Kali and Yupana Wiwattanakantang (CKW 2006).

The 1997 Asian Crisis and its resolution for Thai Banking Industry are briefly examined in the next section. Concept of CG in Thai banking industry is extensively presented, while some characteristics and its development are described in the third section. In the face of the 2008 Global Credit Crisis, some foods for thoughts are given and discussed for further improvement subsequently. Last section concludes.

II. The 1997 Asian Crisis and Its Resolution for Thai Banking Industry

Thailand had enjoyed unprecedented annual double digit growth in early to mid 1990's after its financial liberalization despite of not well developed institutional arrangements. Then the sharp drop in the stock & real estate prices combined with the abrupt rise in interest rate in 1996 aggravated liquidity and solvency problems. Bangkok Bank of Commerce (BBC) was the first bank to collapse in 1996 with

total bad loans equal to 98% of its total asset according to Nukul Commission (1998). By August 1997, out of 91 finance companies, 58 were insolvent and only 33 were deemed viable. To restore the confidence in remaining financial system, explicit blanket guarantee for all banks depositors and debt holders was announced and International Monetary Fund (IMF) was called in to provide financial support and advice.

Many emergency measures were implemented. Financial Sector Restructuring Authority (FRA) was formed; Asset Management Companies (AMCs) were provided to dispose the non-performing asset (NPA); and international standards governing loan classification and provisioning and the interest accrual for the banks were introduced. On August 14, 1998, the financial restructuring package was extensively initiated as summarized in Table 1. In total the government intervened 7 out of total 15 commercial banks.

To deal with further impaired asset, Corporate Debt Restructuring Committee (CDRAC) and the Joint Public-Private Resolution were established in June 1998 for voluntary debt negotiation. The Bankruptcy law was amended and reformed in 1998 and 1999. Soon after the bankruptcy court was established in June 1999. Eventually TAMC was created to take over all banks non-performing loans (NPLs), especially from the state owned banks. The restriction on the foreign ownership in banks was completely relaxed for a period of 10 years to facilitate foreign acquisition and merger. Consequently, consolidation in banking and closure result the number of banks to declined from 15 in 1996 to 13 by 2001. In sum, the industry NPL to good loans ratios have improved materially over the decade as illustrated by Chart 1.

Table 1

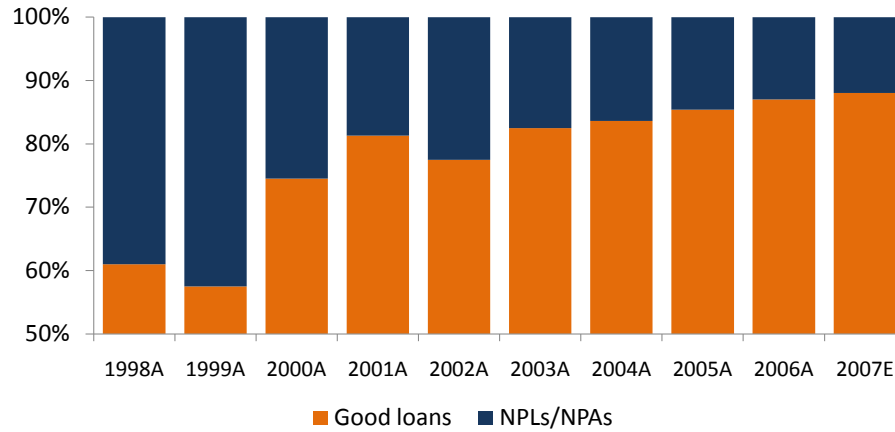
The 14 August 1998 Program

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.	30 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 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
- Adoption plan for completing UB's integration with KTT by 31 December 1998.	31 October 1998
Leam Thong Bank (LTB) - integrated with Radanasin Bank (RSB)	
- After full provisioning, recapitalization up to 8.5% of risk-weighted assets.	31 August 1998
- Adoption 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

Chart 1 : Focus on NPLs & provision for Thai Commercial Banks



Source: ML Phatra (Feb 6, 08)

There was no shortage of citation on poor CG as one of the root causes of the turmoil. Prime Minister named 2002 as “the Year of Good Corporate Governance”. In February 2002, a national committee for CG was shaped to introduce policy measure to improve the level of CG. In March 02, Bank of Thailand (BoT) circulated the primary Financial Institution Directors’ Handbook. By the year end, more guidelines and rules for the restructuring of the composition, qualifications and responsibilities of the board of directors are announced. Audit Committee and Risk Management were required for all banks, while sub-committees for Nomination and Compensation were urged. Table 2 displays the chronology of changes in rules from 1993 to 2002, laws and regulations designed to improve CG practice in Thailand in response to the crisis.

Table 2: Chronology of Changes in Rules, Laws and Regulations designed to improve CG Practice in Thailand

Year	Event	Improves Shareholders' Rights	Improves Effectiveness of the Board	Improve stakeholders' Rights
1993	Regulation requiring at least 2 independent directors on the board	*		
1999	SET establishes Code of Best Practices for directors		*	
	Audit committee required for all listed companies (must have committee formed before the end of 1999)		*	
	Thai Institute of Directors Association established		*	
	Market for Alternate Investment (MAI) established Market rules required more information disclosure as a listing criteria	*		
	Bankruptcy Act - significant amendments made to the Bankruptcy Act, strengthening creditors' rights			*
	New law requires complete disclosure for related parties, inside information, and asset divestitures (Bor Jor 18/2542)	*		
	Updated law changes the definition of "financial statements" to include balance sheet, income statement, changes in equity, and cash flow statement (Bor Jor 18/2542)	*		
	SET issues guidelines for organizing shareholder meetings	*		
2000	Updated laws to require foreign listed firms to disclose at least (or more) information than they report to their country of listing and explanation for accounting rule differences between the two countries (Bor Jor 66/2543)	*		
	Accounting Act passed	*		
2001	SET report on corporate governance released	*	*	*
	First corporate governance baselining study completed, produced together with the Thai Institute of Directors Association and McKinsey & Company, under World Bank sponsorship	*	*	*
	New BoT regulations concerning internal audit of financial institutions		*	
	New BoT regulations for balance sheet and income statement of commercial banks and finance companies	*		*
	New BoT regulations concerning directorship in other limited companies by directors and senior manager of commercial banks		*	
	Updated law to require disclosure of the name(s) of major suppliers that have more than 30% of the firm's transactions (Bor Jor 20/2544)	*		
	New law to provides exception for firms currently under rehabilitation (recovering from financial distress through debt restructuring), which must report financial statements 45 days after the semiannual accounting period (45 days quarterly ending) Firms must report restructuring progress and future obligations, if any (Bor Jor 20/2544)	*		
	Ministry of Finance regulations outline issuing procedure when issuing stock for debt settlement	*		*
2002	Named "Year of Good Corporate Governance"			
	National Corporate Governance Committee established	*	*	*
	Second Thai Institute of Directors Association corporate governance baselinmg study completed	*	*	*
	Thai Rating and Information Services announces It will offer CG ratings	*	*	*
	New BoT regulations concerning lending to or investing in related parties and loans to shareholders of commercial banks and finance companies	*		*
	New BoT regulation covering board structure of a commercial bank to enhance corporate governance		*	
	New BoT regulations concerning approval cneria for external auditors for commercials bank finance companies	*	*	
	New laws shortens reporting time from 60 to 45 days (Bor Jor 47/2545 and Bor Jor 6/2546)	*		

Source: Piman Limpaphayom and J Thomas Connelly (LC 2004) and Bank of Thailand

Before the 1997 fiasco, most of Thai banks were family owned and operated for many decades. After nationalization of partial banking system, state owned banks dominated the industry. Subsequently, foreign ownership plays more meaningful role. Four banks are majority owned by foreigner, while other 4 banks have sizeable (between 20 to 49%) foreign ownership in 2008. Quite a few like Piruna Polsiri and Yupana Wiwattanakantang (PW 2005) perceived family run owned and managed bank associated with inadequate CG during the debacle. It is intriguing to learn that when the dusts are settled and all new banking licenses are to be issued. Thailand ended with more family owned new banks as indicated on Table 3. Could it be natural for entrepreneurial spirit to start the new banking venture and to nurture and to grow into respectable financial institution? Or is it typical Thai and possibly Asian characteristic? More intriguingly, in the global credit crisis aftermath, at least 2 out of 4 Asian banks that are named among the world top 50 safest banks by Global Finance, New York in August 2009 can be classified family majority owned banks, while the rest of the list is mostly state owned or newly nationalized banks.² Perhaps, family owned bank is more afraid of losing its identity than quick profiteering and excess risk taking behavior for mostly diffused owned bank.

In term of the total asset, the type of control and ownership for all Thai banks in selected years from 1996 to 2008 are presented on Table 3. Commercial banks have total asset of THB 8.9 trillion in 2008.. After the nationalization, commercial state banks had its total asset peak at 43.9% of the industry in 2002 and now stood at 27.4% in 2008. Family owned banks that used to dominate the market with 61.9% in 1996 are now at 6.9% in 2008. After consolidation and sold off by Bank of Thailand (BoT), foreign owned banks now represent more than 16.8%, while the diffused ownership classified as other banks commands the highest market share of 48.9%.

Additionally THB2.28 trillions total asset are for all six special purposed state owned (SPS) banks in 2008. This represents another quarter of commercial banking industry. It is also particularly noteworthy that all SPS banks are *not* subjected to BoT regulations, but rather reported and supervised under their relevant ministry. These banks simply enjoy the implicit blanket guarantee by the government since they are wholly owned by the government.

² See more details at <http://www.gfmag.com/tools/best-banks/2341-worlds-50-safest-banks-2009.html>

Table 3
Total Assets Classified by Ownership for Thai Banks

This table shows total assets held by banks classified by ownership. A bank is classified as controlled by these shareholders hold at least 25% of the shares outstanding. Otherwise, the banks are classified as "others." Note that in 2008, the bank that falls into the government, a family, and foreign investors if "other banks" category is the Siam Commercial Bank. Its largest shareholder is the Crown Property Bureau which is subjected to special law.

Commercial Bank

Type of control	1996		2001		2002		2003		2008	
	No. of Banks	% of Total Assets	No. of Banks	% of Total Assets	No. of Banks	% of Total Assets	No. of Banks	% of Total Assets	No. of Banks	% of Total Assets
<u>Commercial Banks</u>										
Government banks	2	25.1	5	42.9	4	43.9	3	33.3	3	27.4%
Family banks	12	61.9	1	9	1	9.3	1	9.9	5	6.9%
Foreign owned banks	0	0	4	7.8	4	7.5	4	7.3	4	16.8%
Other banks	1	13	3	40.3	4	39.3	5	49.6	4	48.9%
Total	15	100	13	100	13	100	13	100	16	100.0%

Note : Commercial Bank 's Total Asset 2008 : 8,921,507 THB

Special-purpose Bank

100% owned by Gov't Special Purposed Banks	2008	
	Total Assets	% of Total Assets
Government Housing Bank	663,773	29.0%
Government Saving Bank	808,616	35.3%
Bank for Agriculture and Agricultural Co-operatives	686,218	30.0%
SME Bank	52,704	2.3%
EXIM Bank	59,852	2.6%
Islam Bank of Thailand	16,785	0.7%
Total	2,287,948	100.0%

Note : Family mean person or group hold share at least 25% of total share

5 New Banking License in 2005 managed by Family (LH Bank, Thanachart Bank, KK Bank, Thai Credit Retail Bank) except TISCO Bank TMB hold by MOF 24% and ING 23% classified State Bank

BAY hold by Rattanak 25% and GE 33% classified Foreign Bank

The Special purposed and State Banks are

- 1) BAAC - Bank of Agriculture & Agriculture Coop, 2) GSB - Gov't Saving Bank, 3) GHB - Gov't Housing Bank and
- 4) SME Bank, 5) EXIM Bank, 6) Islam Bank of Thailand (2007)

In review, Thai banking sector is changing significantly due to regulatory reforms and revamped business models. The implementation of the single presence and universal banking business deregulation in 2006 was *the first wave* to change Thailand's banking landscape according to Vachirapong and Scarff (Feb 08). More consolidation to seek strategic partners is likely to change the major shareholders of Thai banks. Table 4 shows the list of commercial banks and foreign banks with full branches in Thailand in 2008. *The second wave* of regulatory change to further change the financial institutions are the enactment of the new Banking Act and Deposit Insurance Act in 2008. Unified supervision under BoT would change the capital management and competitiveness of the banks; subsidiaries. Franchise value in branch network and large workforce for cross selling may be realized, while the disintermediation process would take place faster in deposit side against the wealth management side rival. *The third wave* has been conjectured in term of intensifying competition for service quality, turnaround time, innovative financial solutions and cost-effective multi-distribution channels.

Table 4 : List of commercial banks and foreign banks in Thailand

Commercial banks registered in Thailand	Foreign banks (Full branch)
BBL	Clayton Corporate and Investment Bank
KTB	JP Morgan Chase Bank
KBANK	Sumitomo Mitsui Banking
SCB	Deutsche Bank
BAY	Societe Generale
SCIB	BNP Paribas
TMB	Indian Overseas Bank
BT	Mizuho Corporate bank
TBANK	The Bank of China
TISCO	Bank of America National Association
KK	The Bank of Tokyo-Mitsubishi UFJ
UOBT	The Bank of Nova Scotia
Standard Chartered Bank	RHB Bank Berhad
ACL	SBN-AMRO Bank
AIG Retail Bank Public	Oversea Chinese Banking
Land and House Retail Bank	HSBC Bank
Thai Credit Retail Bank	
Mega International Commercial Bank	

Source: Company data (Feb 1, 08)

Finally, the global 2008 credit crisis has unfolded itself toward the end of 2008. Though Thai banks have very limited subprime or collateralized debt obligation loans exposure, in October 2008 Thai government had extended the blanket 100% state guarantee until August 2011 to pre-emptive measure to stem the panic fear in the midst of uncertainty. After which the deposit-insurance scheme will replace the blanket guarantee. Comparing to Asian peers, Thai banking balance sheets are relatively strong. High capital reserve with extra provisions completed in 2007 for new requirement stipulated by Basel II accord, low loan to funding ratios and above average equity to asset ratios are among fine key indicators as revealed by table 5. It remains to be seen how this external crisis would shape Thai banking industry, especially from the potential adjustment from the existing foreign bank presence.

Table 5 : Key Ratios for Asian & Thai banks

2Q09	Loan to funding	% Tier-1	% total CAR	LLR coverage	Equity to asset	ROE	NIM	NIM-net of credit cost	Cost to income
China	68.00%	9.38%	11.87%	143.00%	5.80%	20.42%	2.17%	1.73%	38.00%
Hong Kong	51.00%	10.90%	15.50%	72.10%	7.44%	16.47%	1.26%	1.06%	36.60%
Korea	116.02%	10.03%	14.07%	116.40%	5.87%	10.20%	1.92%	1.01%	46.70%
Singapore	84.00%	13.40%	16.40%	83.90%	10.40%	9.60%	2.17%	1.05%	36.00%
Indonesia	77.40%	14.60%	15.80%	163.70%	10.60%	21.40%	8.00%	5.40%	46.50%
India	74.2%	9.6	14.6	60.4%	6.7%	19.3%	2.8%	2.5%	50.3%
Thailand	84.0%	12.1%	15.8%	70.6%	9.5%	15.0%	3.3%	2.6%	56.8%
BBL	75.8%	12.1%	15.0%	70.6%	10.3%	10.9%	3.00%	2.51%	51.5%
KTB	85.5%	9.8%	15.5%	107.7%	7.2%	10.0%	3.19%	2.72%	60.4%
SCB	85.3%	11.4%	15.7%	84.0%	10.0%	16.8%	3.42%	2.95%	50.1%
KBANK	89.1%	10.4%	15.9%	90.8%	9.8%	13.0%	3.73%	2.88%	54.1%
BAY	94.3%	12.9%	15.9%	65.2%	12.1%	12.9%	3.71%	2.40%	58.3%
TMB	79.0%	13.1%	15.0%	59.9%	8.1%	7.3%	2.23%	1.31%	72.8%
SCIB	78.5%	10.3%	14.3%	65.7%	9.7%	9.0%	3.12%	2.41%	59.0%
TISCO	97.3%	10.1%	14.3%	69.0%	8.8%	16.8%	4.35%	3.32%	49.4%
TCAP	85.5%	14.2%	16.7%	87.3%	7.5%	21.0%	3.67%	2.31%	55.9%
KK	81.7%	16.4%	16.9%	51.5%	14.2%	11.3%	3.94%	3.91%	56.3%

Source: RBS (Sept 25, 09)

Special Purpose State Banks in Thailand

2Q09	Loan to funding	% Tier-1	% total CAR	LLR coverage	Equity to asset	ROE	NIM	NIM-net of credit cost	Cost to income
GHB	88.00%	10.33%			4.40%	11.32%	1.94%		91.07%
SME	71.19%	7.57%			6.27%	-49.73%	0.93%		218.23%
GSB	77.64%	15.48%			9.86%	16.27%	3.55%		43.78%
BAAC	76.97%	n a			9.15%	10.10%	6.21%		86.89%
EXIM	85.48%	19.10%			16.42%	2.03%	0.40%		101.28%
Islam Bank	78.68%	n a			18.89%	-1.70%	1.40%		139.12%
Average	79.66%	13.12%			10.83%	-1.95%	2.41%		113.39%

Source: Authors' Estimate

Note : 1. Cost to Income = (Interest Expense + Non-interest Expense + Debt Loss) / (Interest and Dividend Income + Non-interest Income)
2. Islam Bank of Thailand based on Financial Statement Year 2007 audited by Office of the Auditor General

State Commercial Banks in Thailand

2Q09	Loan to funding	% Tier-1	% total CAR	LLR coverage	Equity to asset	ROE	NIM	NIM-net of credit cost	Cost to income
KTB	85.5%	9.8%	15.5%	107.7%	7.2%	10.0%	3.19%	2.72%	60.4%
TMB	79.0%	13.1%	15.0%	59.9%	8.1%	7.3%	2.23%	1.31%	72.8%
SCIB	78.5%	10.3%	14.3%	65.7%	9.7%	9.0%	3.12%	2.41%	59.0%
Average	81.00%	11.07%	14.93%	77.77%	8.33%	8.77%	2.85%	2.15%	64.07%

Source: Authors' Estimate

Private Commercial Bank

2Q09	Loan to funding	% Tier-1	% total CAR	LLR coverage	Equity to asset	ROE	NIM	NIM-net of credit cost	Cost to income
BBL	75.8%	12.1%	15.0%	70.6%	10.3%	10.9%	3.00%	2.51%	51.5%
SCB	85.3%	11.4%	15.7%	84.0%	10.0%	16.8%	3.42%	2.95%	50.1%
KBANK	89.1%	10.4%	15.9%	90.8%	9.8%	13.0%	3.73%	2.88%	54.1%
BAY	94.3%	12.9%	15.9%	65.2%	12.1%	12.9%	3.74%	2.40%	58.3%
TISCO	97.3%	10.1%	14.3%	69.0%	8.8%	16.8%	4.35%	3.32%	49.4%
TCAP	85.5%	14.2%	16.7%	87.3%	7.5%	21.0%	3.67%	2.31%	55.9%
KK	81.7%	16.4%	16.9%	51.5%	14.2%	11.3%	3.94%	3.91%	56.3%
Average	87.00%	13.57%	15.97%	69.27%	10.17%	16.37%	3.99%	3.18%	53.87%

Source: Authors' Estimate

III. The Concept & Evolution of CG in Thai Banking Industry:

1) The Banking law and regulation

With regards to CG, all commercial banks in Thailand must follow the new Financial Institutions Business Act (the "Act") which became effective on 3 August 2008 and specific guidelines issued by the Bank of Thailand (BoT). This new Act replaced the Commercial Banking Act, and the Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business. It standardizes the existing different regulations governing commercial banks including subsidiaries, branches of foreign banks, finance and securities companies, credit foncier companies and specialized financial institutions. The new Act contains provisions dealing with (i) the shareholding limit of individual investors in financial institutions, (ii) the shareholding restrictions of financial institutions in other financial institutions who conduct the same type of financial business, (iii) the BoT's supervisory role over the operations of the entire group of financial institution as well as (iv) the BoT's right to step in, in case of a financial institution's failure to maintain its capital funds.

BoT is responsible for regulating banks and financial institutions in Thailand by issuing guidelines through announcements and circulars (see Table 2). These announcements and circulars are continuously updated to reflect the changing financial environment and to coincide with best governance practices of domestic and international organizations such as the Securities Exchange of Thailand (SET), the Institute of Thai Directors (IOD)³, the Basel Committee on Banking Supervision (BIS) and the Organization of Economic Cooperation and Development (OECD). (See Table 2) Indeed, the OECD guidelines are directly transferable to the Principles of Good Governance stipulated by SET⁴ as claimed by LC 2004, p. 6. Since all Thai majorities owned banks are listed in SET, all these codes are also applied apart from BoT regulations. It is particular noteworthy all foreign owned banks in Thailand have their parent companies that are publicly listed and subjected to their home SEC, stock exchange and central bank regulations apart from BoT's one and group head office internal audit. These are redundant in any standard. Few claim regulatory arbitrage is possible in theory, but yet to be found in Thailand.

³ IOD was established and partially funded by the World Bank at the inception.

⁴ See more details at http://www.set.or.th/en/regulations/cg/update_doc_database.html

An overview of the CG functions of the Thai banking system include oversight by the board of directors, managerial functions by senior management, compliance to banking laws and regulations of governing bodies, internal audit within banks and financial institutions, legal/financial advisory function by legal counsel and financial analysts. Major bank as in any corporate transactions such as merger, sales of assets, new share issues, etc. require at least 75% majority vote with the absence of related parties voting. As the cornerstone of minority shareholders protection, connected and related parties transactions must be approved by independent directors with timely and full public disclosure. Moreover, external audits by independent agencies and reports to shareholders further support good governance in order to maintain public trust and investor confidence. All banks, unlike other listed corporation, are required to change their external auditors within 5 years that the auditors serve.

The process of good governance includes board members setting appropriate policies and strategies including the structure of responsibilities and setting appropriate controls. The policies and procedures should be approved by the board for senior management to oversee operations, monitor, and assess the different functions while having in place problem solving and formal approval procedures. Regulations on CG of Thai banks follow the eight corporate governance principles of the Basel Committee (February 2006). In addition, to achieve effective governance of compensation and the alignment of compensation with risk taking of commercial banks, the BoT guidelines coincide with the Financial Stability Board (FSB) principles on CG as well.

In 2009, BoT has recently updated guidelines on CG particularly focusing on three main areas of composition of the board members, qualification of the board members, and the important duties and responsibilities of the Board. These guidelines serves the purpose of providing a clear and coherent framework of CG by taking the previous principles from previous years and separating into distinct points and also to make the guidelines more in line with the Securities and Exchange Act of 2008. Due to the position and responsibilities of the Board having to oversee many facets of the bank's operations, the BoT places the most emphasis in the role of the Board in 4 areas of risk management, capital adequacy, compliance roles, and good CG so that financial institutions can operate under laws and regulations.

2) Board Composition and structure

Since the severe adverse effects of the 1997 financial crisis on the Thai economy, commercial banks have had to enhance their CG framework amidst continuous economic volatility as well as increasing complexity and competition in the financial services industry. Thai banks have been able to implement various internal structural reforms including but not limited to revising approval and reporting policies and procedures as well as formation of various independent committees including risk management committees, internal audit committees, and remuneration committees. In order to ensure good CG of banks and financial institutions in Thailand, BoT has put forth the following guidelines pertaining to the structure of a commercial bank's CG committee, qualifications of the Board of Directors, and prevention of conflict of interest or the role of independent committee members.

The BoT specifies that to enhance CG, close attention should be paid to the board members, who are entrusted by shareholders with the task of safeguarding their interests and increasing the long term value. To promote good governance practices in the organization, the board must formulate business strategies as well as oversee that the bank abides by the laws and regulations. The BoT guideline requires that the bank must have a Board of Directors and **2 mandatory committees** - the Audit Committee and the Risk Management Committee, and should have **voluntary committees**, such as a Remuneration Committee, and Nomination Committee. The guideline establishes that the board should possess leadership and appropriate qualifications and composition of the Board Committees as a prerequisite for bank's operations and governance. Qualifications of the Board of Directors should follow the **"Fit and Proper" guidelines** such as having the competence, capabilities, and experiences that would be beneficial to manage a financial institution as well as being honest, has integrity, and has a good reputation. For example, the individual should never have been removed by neither the Securities and Exchange Commission (SEC) nor the BoT from managing a financial institution and has no history of committing or being a part of consumer fraud. Besides, the individual must be financially sound and should not have any past history of missing payments on principle and interest to a financial institution.

As for structure of the board, the bank's Board of Directors follows the requirements of the Securities and Exchange Act which states that:

(1) At least one third of the board size shall be independent directors and in any cases, the number shall not be fewer than three;

(2) Each independent director shall comply with the following rules:

(a) holding shares not exceeding one per cent of the total number of shares with voting rights of the applicant, its parent company, subsidiary company, associate company, major shareholder or controlling person, including shares held by related persons of such independent director;

(b) neither being nor used to be an executive director, employee, staff, advisor who receives salary, or controlling person of the applicant, its parent company, subsidiary company, associate company, same-level subsidiary company, major shareholder or controlling person, unless the foregoing status has ended not less than two years prior to the date of filing an application with the Office. Such prohibited characteristic shall not include the case where the independent director used to be a government official or advisor of a government unit which is a major shareholder or controlling person of the applicant;

(c) not being a person related by blood or legal registration as father, mother, spouse, sibling, and child, including spouse of child, executive, major shareholder, controlling person, or person to be nominated as executive or controlling person of the applicant or its subsidiary company;

(d) neither having nor used to have a business relationship with the applicant, its parent company, subsidiary company, associate company, major shareholder or controlling person, in the manner which may interfere with his independent judgment, and neither being nor used to be a significant shareholder or controlling person of any person having a business relationship with the applicant, its parent company, subsidiary company, associate company, major shareholder or controlling person, unless the foregoing relationship has ended not less than two years prior to the date of filing an application with the Office.

The Board's functions can be divided into 2 categories: basic functions and specific functions. The basic functions include 1) define the overall direction and strategies of the bank, approve policies and ensure that they are implemented to protect the interest of the bank and its shareholders, 2) ensure the institution of internal codes of ethics, codes of conduct for directors, management and employees, 3) review the bank's operations continuously to comply with the laws and approved policies, 4) ensure

competent management of the bank including appointment of senior executives, 5) ensure the institution of effective systems for internal control and audit 6) ensure that management refers significant banking issues to the board. Some specific functions include approving and reviewing risk management policies, approving functions and responsibilities of sub committees as well as changes in their composition, has understanding of regulations on related entities loan, and requirement of directors be in attendance in at least a half of the board meetings every year.

Due to the increased responsibility of the board as well as the complexity of its tasks, the BoT requires the appointment of sub committees whose members possess appropriate qualities to help the board to perform its duties effectively. How many subcommittees should be established depends on individual bank's needs. However, it is mandatory that each bank set up an Audit Committee and a Risk Management Committee. The audit committee should comprise of at least 3 members, of which all should be independent directors. The audit committee member should not be a member of related firms that is registered in the stock market and at least one of the committee members should have adequate knowledge and experience to review the reliability of financial statements. The duties of the audit committee are to supervise the preparation of financial reports and to audit compliance with commercial banking laws and regulations. The audit committee main functions and responsibilities include reviewing the bank's financial reporting process, evaluate the internal control system and internal audit, ensure compliance with the Commercial Banking Act, the Securities and Exchange Law, regulations of the exchange or laws related to business of the commercial bank, select and recommend remuneration of the bank's external auditor, disclose information that may lead to conflict of interest, prepare a report on monitoring activities of the audit committee and disclose it in an annual report of the commercial bank, set up duties of the audit committee and report to the board of directors of any misconduct found.

The risk management committee should comprise of at least 5 members who are board directors and/or management with the majority of the directors having knowledge, experience, and understanding related to the overall risks. The chair of the risk management committee does not have to be the chief executive officer. The risk management committee has the functions and responsibilities of proposing to the board a policy for overall risk management, formulating strategies and assessing, monitoring, and ensuring that the bank's risks are at appropriate levels, reviewing the adequacy of the bank's risk management policy and system, and regularly report to the audit committee.

The necessary component of CG is the appointment of *Independent Directors*. The Independent directors should not have any commercial-banking related business or work that may affect their decision. Specifically, they 1) should not hold shares in excess of 1 percent of the issued shares of the commercial bank, subsidiary company, associated company, and related company including shares held by a related person, 2) should not take part in the management, be a staff member, or paid advisor of the commercial bank, subsidiary company, associated company, related company or major shareholders of the commercial bank, 3) should not have any direct or indirect benefit in financial and management of the commercial bank, subsidiary company, associated company, related company or major shareholder of the commercial bank, and 4) should not be related to or close relative of a senior executive or a major shareholder of the commercial bank.

Furthermore, the BoT guideline also states that Banks should have voluntary committees such a Nomination Committee and Remuneration Committee where this committee should have at least 3 members, *all non-executive*, and should be chaired by an independent director. The nomination committee is responsible for nomination of directors and senior executives while the remuneration committee is responsible for setting policies on remuneration of directors and senior executives. The BoT determine the regulation that commercial banks should appoint a committee to determine the compensation of the Board members who are not part of management and are assigned to monitor and determine the compensation policy and other benefits to prevent conflict of interest. The Bank of Thailand as regulators has the authority to examine commercial banks to determine that there are appropriate compensation policies in place and that there is segregation of duties and appropriate checks and balances. Also the BoT determined that the Remuneration Committee of commercial banks have the responsibility to oversee the determination of the rate of compensation that is not closely linked to short term profits while neglecting the long term value to shareholders in order to receive high short run returns. The commercial banks should disclose the compensation policy in the bank's annual report and disclose the benefits and remuneration of the Committee members at the Shareholder's meeting. The functions and responsibilities should include 1) recommend remuneration and benefit policy as well as amount of the board and senior executives with clear and transparent criteria for consideration and approval by the board, 2) ensure the board and senior executives remuneration is commensurate with their duties and responsibilities, 3) devise performance assessment criteria for board members and senior

executives for annual remuneration review, taking into account their responsibilities and risks as well as enhancement of long-term shareholder value, and 4) disclose the remuneration policy, actual payment in various forms, and remuneration committee's report that at least covers the objectives, activities, and opinion of the committee in the bank's annual report. The remuneration committee should meet at least twice a year and may seek professional advice from outside sources.

3) Assessment and Effectiveness of CG in Thai banks

BoT has placed emphasis on "having the right people" on the Board of Directors of commercial banks with explicit guidelines and details as stated in previous section. The right mix of skill, talent and experience for directors with different background (e.g. banking, finance, accounting, legal, marketing, IT etc) is also crucial for the effective board though BoT does not specified. Table 6a highlights the Board Committee Characteristics for Thai banks as of the end of 2008. All banks have Audit Committee and Risk Management Committee as required by BoT. Interestingly while all commercial banks have nomination and compensation committees as urged by BoT, only half of the SPS banks compile as indicated on Table 6 a.

Table 6a - Board Committees: Characteristics (2008)

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 2008. The total number of banks operating in 2008 is 16 (Commercial Bank) and 4 (Special-purpose Gov Bank)

Commercial Bank	Audit Committee	Nomination Committee	Compensation Committee	Risk Management Committee
% of banks where the committee exists	100.0	100.0	100.0	100.0
Number of total members	3.2	3.1	3.1	6.5
Number of independent directors	3.1	1.8	1.8	0.0
% of banks where the committee is chaired by independent director	100.0	0.9	0.9	0.0
Number of Bank	16	13	13	8

Note : 3 banks have member of nomination and compensation committee in board of director but have no detail (CMIBT, SCBT, Thanachart Bank)

: 8 banks have member of risk management committee in organization structure or board of director but have no detail (KTB, CMIBT, SCIB, SCBT, UOBT, LH BANK, Thanachart Bank, TISCO BANK)

Nomination Committee and Compensation Committee is the same committee under name " Nomination and Compensation Committee"

Special Purpose State (SPS) Bank	Audit Committee	Nomination Committee	Compensation Committee	Risk Management Committee
% of banks where the committee exists	100.0	50.0	67.0	100.0
Number of total members	3.2	6.0	5.3	5.8
Number of independent directors	3.0	3.0	3.0	1.0
% of banks where the committee is chaired by independent director	100.0	100.0	100.0	40.0
Number of Bank	6	6	6	6

Note : BAAC , GHB , GSB, SME Bank are not under Banh of Thailand 's regulation

BAAC and SME Bank have Labor Relationship Committee replace to Nomination Committee and Compensation Committee

Total	Audit Committee	Nomination Committee	Compensation Committee	Risk Management Committee
% of banks where the committee exists	100.0	90.0	90.0	100.0
Number of total members	3.2	3.5	3.5	6.3
Number of independent directors	3.1	1.9	2.1	0.4
% of banks where the committee is chaired by independent director	100.0	89.0	89.0	13.0
Number of Bank	22	19	20	15

Note : 16 Comercial Bank 4 Special Purpose Gov Bank

Table 6b - Board Member Characteristics in Thailand (2009)

	Firm Code	Total Number of Director	Number of Directors on each board		No of Executive (X) Directors		No of Non-X Directors		No of Independent (I) Directors		No of Audit Committee		No of director from Family or related	Major Shareholder						Note		
			Thai	Foreigner	Thai	Foreigner	Thai	Foreigner	Thai	Foreigner	Thai	Foreigner		Family	%	Foreigner	%	Other	%			
	Commercial Banks																					
1	BBL - Bangkok Bank	20	20		10		10		6		4 + 1 Exec		3	Sophonpanich	4.28						Major shareholder base on share hold by Thai person and juristic person	
2	KTB - Krug Thai Banks	13	13		4		9		8		3							FIDF		56		
3	BAY - Bank of Ayudthaya	11	8	3		2	8	1	4		3			Rattanak	25.00	GE		33.00				
4	KBANK	15	13	2	2		11	2	6	2	3	1	3	Lamsam	N/A						Most of shared hold by nominee	
5	KK Bank	10	10		3		7		4		3		1	Wattanawekin	24.39							
6	TMB Bank	11	7	4	3	2	4	2	3	1	3		2	MOF	22.56	ING		23.4				
7	TISCO Bank	12	9	3	2	2	7	1	4		3										Hold by nominee related to TISCO , Banker Trust	
8	CIMBT Bank	9	5	4	1	2	4	2	3	1	3					CIMB BANK BERHAD		93.1			Take over by CIMB Group and changed name to CIMB Thai Public Company on Nov 4, 2008	
9	SCB - Siam Commercial Bank	16	13	1	4		9		9		3							Crown Property Bureau		30.92		
10	SCIB - Siam City Bank	12	10		4		6		5		3							FIDF		47.58		
11	UOBT Bank	10	3	7	0	3	3	4	3		3					UOB		99.00			Delisted from SET August 2006	
12	SCBT - Standard Charter	9	5	4	0	1	5	3	3	0	3							Standard Charter		99.83	Delisted from SET July 2007	
13	ACL Bank	11	11		5	0	6	0	4		3			Bangkok Bank	28.13							
14	LH Bank	9	9		4	0	5	0	4		3		1	LH Group	98.00							
15	Thai Credit Retail Bank	9	9		4	0	5	0	3		3		2	Chaiwan (Thai Insurance Group)	98.00							
16	Tbank (Thanachart)	10	8	2	2	0	6	2	3		3		2	Thanachart Capital	50.92	Bank of Nova Scotia		49			Partner with Bank of Nova Scotia on 2007 and delisted from SET on Jan 14, 09	
	Average =	11.69	9.56	3.33	3.20	1.20	6.56	1.55	4.50	1.00	3.00											
	Special Purpose State Banks																					
17	GHB	11	11	0	5	0	6	0	7		3											State Bank
18	GSB	9	9	0	4	0	5	0	3		3											State Bank
19	BAAC	14	14	0	1	0	13	0	7		3											State Bank
#	SME Bank	11	11	0	1	0	10	0	10		1	0		0	0	0		4				
21	EXIM Bank	11	11	0	4	0	7	0	10		1	0	4	0	0	0		3				
#	Islam Bank of Thailand	8	8	0	4	0	4	0	7		1	0	3	0	0	0		3				
	Average =	11.20	11.20	0.00	3.00	0.00	8.20	0.00	7.40		2.20											

Note : 1) Source: Data base on company website and SETSMART

2) The Special purposed and State Banks are 1) BAAC - Bank of Agriculture & Agriculture Coop, 2) GSB - Gov't Saving Bank,

3) GHB - Gov't Housing Bank and 4) SME Bank - Small & Medium Enterprises (est in 2002).

The average size of the commercial bank board is large and equal to 11.69 persons mostly are Thai nationality as depicted on Table 6b. Foreign wholly owned banks (e.g. UOBT and SCBT) have dominant numbers of foreign directors on the board for management and control whereas foreign majority owned banks (e.g. TMB, CIMB and BAY) have their sizable number of their people on the board to look after their interests. Large banks (e.g. BBL, KTB, KBank and BAY) have nearly all non-executive directors on the board and typically more numbers of independent or outside directors than small banks (e.g. CIMBT, UOBT, LH and TBank). All banks except BBL⁵ have their audit committees consisted of 3 independent directors, mainly Thai. Family owned banks (e.g. BBL, Kbank, KK Bank, etc.) have their family members on the board and as top executive positions like Chairman or CEO. At the same time, state owned banks tend to assign current top governmental officials especially from MoF for top executive posts. It is critically important to note that from Table 6c, all banks have CEO who does not serve as Chairman of the Board concurrently as suggested by BoT's handbook. Nearly all Chairman and CEO are male with at least a bachelor degree in mostly finance, economic and accounting background.

⁵ BBL has four independent directors and one executive for its Audit Committee.

Table 6c
Chairperson and CEO: Characteristics

This table presents the characteristics of banks' Chairperson and CEO as of 2008. 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 16 (Co-commercial Bank) and 4 (Specific-purpose Bank).

Characteristics for Commercial Bank	The Chairperson	The CEO
Family member of controlling shareholder	4	3
Former officer of the Bank of Thailand, Ministry of Finance, or other financial supervisory agency	4	0
Former elected or non-elected politician	1	2
Having a highest degree as BA level	6	2
Having a highest degree as MA level	5	11
Having a Ph. D degree	4	1
Having background in finance or economics	10	13
Having background in accounting	1	0
Having background in law	2	0
Female	1	0
Foreigner	1	3
Characteristics for Specific-purpose Bank	The Chairperson	The CEO
Family member of controlling shareholder	0	0
Former officer of the Bank of Thailand, Ministry of Finance, or other financial supervisory agency	4	0
Former elected or non-elected politician	2	0
Having a final BA degree	1	0
Having a final MA degree	2	4
Having a Ph. D degree	3	2
Having background in finance or economics	4	3
Having background in accounting	0	0
Having background in law	1	1
Female	0	0
Foreigner	0	0

Note: Specific-purpose Banks are BAAC, GHB, GSB , SME Bank

Regarding SPS Banks, the average board size is about 11.20 persons and all are Thai nationality. It is captivating to note that all SPS banks except GSB have majority of the board as non-executive and mostly independent directors. Since nearly all of the SPS directors are assigned according to ranks and file and politically appointed, it appears to be the board for national policy directive and political agenda. In fact, all SPS bank chairpersons are either former top government officers or politician as given on Table 6c. Only half SPS banks have 3 independent directors for Audit Committee. Regarding to the

nomination and compensation committee, each GSB and GHB have one but BAAC and SME banks do not have. Instead BAAC and SME bank have joint “employee and executive” board to oversee their labor relationship. It seems that BAAC and SME are the only two Thai banks that truly have labor representatives on the board.

Like any corporate, banks are subjected to external audit process from charter accounting firm. Unlike any corporate, banks are even more scrutinized since banks are custodian of public money. Banks and their subsidiaries are additionally and regularly subjected to both on-site and off-site inspection by its regulator – BoT. Typically, off-site examination through banks’ reports like financial performance, off-balance sheet trading activities, loan quality and top 20 loans details would be continuously checked and compared to its peer. BoT will also make an onsite visit to each and every commercial bank at least once a year. The real effectiveness in good governance in Thai banks from the onsite inspection by BoT examination team cannot be overemphasized. At the minimum, the onsite examination report would give a brief summary as shown in Table 7. In our sample case, the report would indicate the level and trend of five different banking risks (e.g. strategic, credit, market, liquidity and operation) to be compared with the previous examination. Often, bank performances (e.g. NPL level, provision, Tier I and II Capital, etc.) are compared directly to the industry and with peers. All examination reports are required to be tabled and considered for appropriate responses, if any, by the next meeting for the board of directors.

Table 7: Example of Summary Report from BoT's annual on-site Inspection.

	Previous Inspection		Current Inspection	
As of	June 30, 07		March 31, 08	
Aggregate Rating	4 (Somewhat Weak)		3 (Satisfied)	
Risk	Level	Trend	Level	Trend
1. Strategic	Very High	Increasing	Very High	Stable
2. Credit	High	Stable	Medium	Stable
3. Market	Low	Stable	Medium	Increasing
4. Liquidity	Medium	Decreasing	Medium	Stable
5. Operation	Very High	Stable	Very High	Decreasing

Signed by Head of Inspection team 1, Department 1

IV Some Comments on CG in Thai Banking Industry in the midst of the 2008 Global Credit Crisis:

1. **Thai Banking Characteristic & CG:** The CG for bank is much different from CG for typical corporate due to its unique banking characteristic as shown on Table 8. First, market structure for banks in Thailand is monopolistic or oligopolistic depending on market segment. The top 5 banks commanding more than 60 percent of the market share. Second, bank is opaque as suggested by Dipinder (2005). There are a large information gap in scope and scale between management and other stakeholders. This makes the principal-agent or agency problem in Jensen and Meckling (1976) sense fares more complex than typical corporation. The more financial innovation and the more relationship based activities banks engage, the more asymmetric information gap is going to be between management, the board of directors, shareholders and regulators. Corporate executives are often well-informed with the mechanic rules. Thus, there are associated soaring agency cost and high monitoring cost. Third, bank is highly leverage and borrowed essentially from public household saving. Bank failures or run on banks create huge negative externalities. Forth the regulations for banks are intensive and extensive with possible third party involvement and intervention that go beyond the objective of safety and stability. Finally, the bank ownership structure in Thailand and possibly in Asia is not fragmented. Its ownership tends to be highly concentrated, either family owned or state owned.

Table 8 Challenges of Governance of Financial Institutions

	Assumptions underlying traditional model	Banks
Market Structure	Competitive	Banking structures tend towards monopolistic or oligopolistic competition
Info Asymmetry	Forms crux of agency problem	Agency problems fare more complex. Banks are opaque
Capital structure	Low leverage ration	Highly leverage
Regulation	Common for all sectors	Intensive & extensive regulations with intervention of 3 rd party
Ownership	Dispersed or a few controlling owners	Family and state owned

Source: Dininder S Randhawa (2005)

The CG begins inside the company when the ownership and management are *separated*. And the company has limited liability. In Jensen and Meckling sense, the agency problem arises when one party to act on behalf of another. The main players in a corporation are the shareholders, management and the board of directors. Each interacts and plays “games of corporate life”. Each has different roles and fiduciary duty to work together. Each supposedly has one common goal – to *optimize* aggregate value of the firm and shares *fairly* among other stakeholders [e.g. minority shareholders, employees, suppliers, customers, bankers, regulators, community at large, etc.] in given sets of environment and constrain.

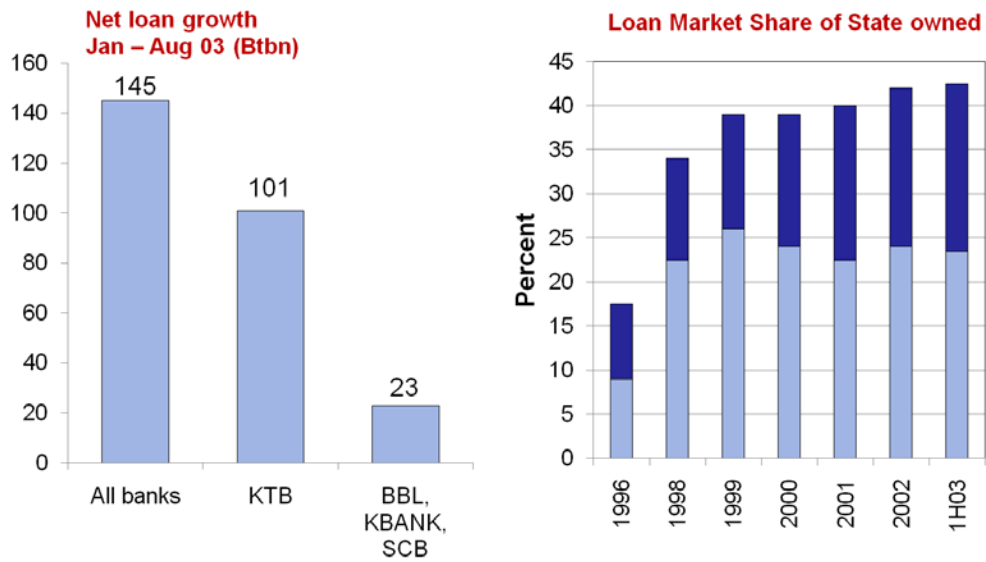
Most of CG rules and guidelines, particularly from the West have one implicit assumption of separation of ownership and management in Jensen and Meckling sense. When bank’s ownership is widely dispersed among people with no interest in profitability or proper conduct, CG is crucially needed. When Thai banks (or corporate in this matter) have family or a group majority own, there is a blur distinction between ownership and management. The primary concern seems to be **minority shareholders appropriation**. CG guidelines calls for transparency, disclosure, accountability and integrity may protect minority shareholders interest. Thai CG has evolved materially in this area. However if the Thai banks or any corporate is wholly state owned like SPS bank case, the challenge becomes **common agency problem** with multiple objectives. BAAC enjoys Thai sovereign credit rating, for instance, though it has very poor financial return performance as shown on Table 5. This rural lender has dual roles to find funding and, if possible, profit, while to help or to even subsidize the farmers and underprivileged in general according to national policy. As a matter of fact, the SPS banks are on average the least efficient banks judging from cost-to-income ratios. Tax payers stand to lose out in this case, but for whose benefits or for social welfare enhancement. Apart from usual transparency and timely disclosure for good CG, social contract between wholly state own bank and public is needed. Freedom of media and public scrutiny as well as participation to check on its prioritized goals given by the board may, hence, be the keys to resolve these common agency issues.

Still the worse may be the listed bank (or any corporate) structure with the combination between majority state owned and sizeable family and group influential (e.g. KTB, SCIB, etc.) control through political process and/or equity controlling ownership. *Quasi* state privilege and connection yields lower funding cost, gives upper hands on state related projects and may have leeway on supervision. This distorts market mechanism. At the same time, political as well as personal hidden agenda from their

management and power-that-be are also serious concerns. One good example is during the 2000 to 2005 when the government decided to use state commercial banks as *quasi*-fiscal stimulus tool for rapid economic recovery by aggressively extending credit to the system. By mid 2003 Thai state bank lending completely dominated the total loan market share as illustrated on Chart 2a. It crowding out private banks and distort the market mechanism. The net result as reveal on Chart 2b is the sharp rise in state banks NPL. Though the total state bank loan portfolio represented only 21% market share, the total state bank NPL stood at 40% of total industry as of June 30, 09. The THB 46 billion lax lending legal case in 2004 against the CEO of the KTB - the largest state bank, for an example, is the reminder of political appointed top bank official for political agenda as discussed by PW (2005, p. 18). For another instance, using cost-to-income ratio as efficiency measurement, state-own majority banks in 2009 has consistently far below performance than the private majority own banks as shown on Table 5. This **multiple principal-common agency problems** in Bernheim and Whinston (1986) sense case of ever increasing complex agency dilemma, not covered by typical CG principles. And CG trainings are often overlooked. But the social welfare losses are great since these state owned banks (or corporate) generally are prominent in scale, scope and privilege.⁶ Prominent conflicts of interests are existential. Perhaps, the first policy decision on CG is to make a choice for these state banks to be either wholly state owned or private listed majority owned operation but not both.

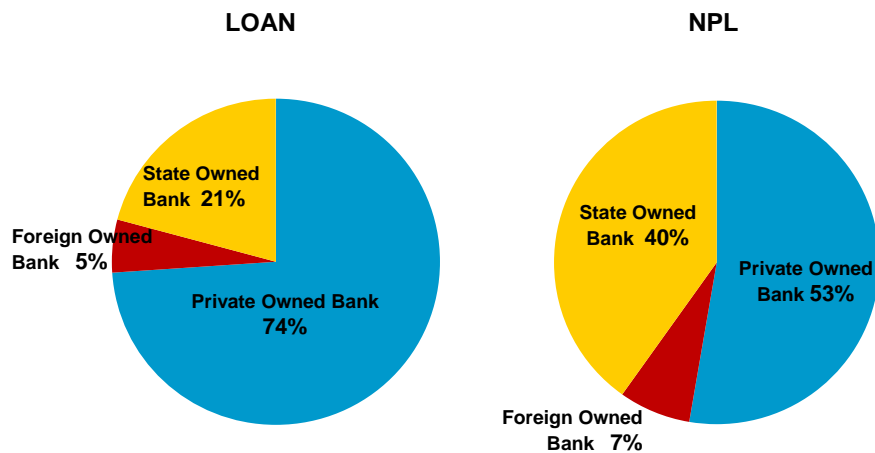
⁶ It is very interesting to note the parallel situation in China at present. In order to avoid the economic crash caused by the global credit crisis, Chinese government has deliberately instructed its state banks to lend aggressively in 2009. This was roughly about one trillion RMB per month. Though Chinese has reached its objective, the cost of this implementation is unknown. The asset bubble is in the waiting whereas the NPL issue has not fully revealed.

Chart 2a : Thailand State Bank Lending Dominance in the 1997 aftermath



Source: Bank of Thailand (June 30, 03)

Chart 2b: Thailand's Commercial Banking Industry as of June 30, 03



Based on data from Bank of Thailand

2. **Risk Management, Revenue Generating and CG in Thai Banking:** CG of the banking sector is perceived to be identical with risk management of bank. Connected lending, crony capitalism, every-greening loans and creative accounting through financial innovations are thinly veiled euphemism for what are essentially corrupt practices. Nevertheless, true arm-length transactions and reasonable proprietary trading monitoring, especially on derivative products can only be handled by integrity and capable independent directors. When BoT delegates heavy responsibilities, BoT should empower independent director. Without solid backing of necessary resources and authority from BoT and the board, too much burdens placing on independent directors is provided a fertile ground for collusion with management to cover up.

Taking all Western standards and guidelines to be used in Thai context may not be entirely relevant. LC (2004, p. 41) conclude official recognition on Thai actual context and characteristic are needed. Implementing narrow measures to treat symptoms and ignoring the underlying causes would not improve much of CG system. A reactive strategy of CG adaptation from Western practices by various supervisory and regulatory institutions with no clear strategic direction and shared by all related parties, LC (2001, p. 40 to 41) conjecture as undesirable.

On the other hand, Thai banks display this weakness evidenced by high cost-to-income ratios on Table 5. Maybe too much focus on risk management may weak banks performance. It leaves no room for risk taking for profit making. The key is to develop risk taking capacity for appropriate risk reward profile. At the end, banking business is in a risky business. Bank cannot avoid taking risk. The key question is how bank has to prudentially take risk and get smartly compensated for this risk appetite. Healthy banks are the enterprises that make money and have sufficient capital and liquidity.

2.1 Micro & Macro Prudential Regulation: Financial crises are generally macro in nature, but regulation is essentially micro as summarized by the Warwick Commission (2009). CG is fundamentally micro prudential regulation focusing on individual institutions, instruments and process to be fair and sound for all stakeholders. In the wake of the 2008 global credit crisis, it is obvious that this micro approach must be supplemented by macro-prudential regulation of the financial system. Where risks are *endogenous* to the financial system, micro prudential is insufficient. What seems to be reasonable micro-prudential directive can create endogenous risks. One fine example is the simple rule of requiring

banks to have more provision if the assets they hold are rated non-investment grade by external credit rating agency. But imagine if the economic recession sets in and triggers a rating downgrade that leads all asset holders to sell at the same time, this cause the credit price to crumple. This turmoil triggers risk management committee to recommend the allocation of more capital and cash reserve against all credit risks and lead banks to sell other instruments to raise more cash. This leads to general decline in asset prices and increase high price volatilities and correlation that increases measure risk. The vicious cycle set in. In practical sense, there can be a trade-off between micro and macro prudence as US and Europe has done enormously in order to combat the current global credit crisis. Lower the interest rate to near zero to ease business financial distress, amending accounting rules like mark-to-market based clause IAS 39⁷ to decelerate book value loss and relaxing regulations to expedite deposit banking licenses to investment banker for liquidity injection are some fine examples of resilience of Western supervision. (See more discussion by Hoontrakul (2008) and below). This is actually the opposite of what we had done during the 1997 crisis.

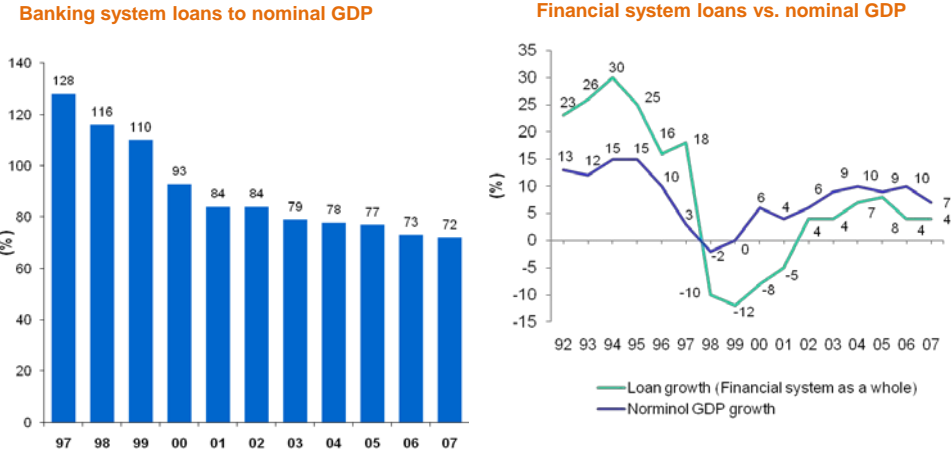
After a decade long of pursuing international standards and level banking industry, the world is now facing with the same systemic risk that prune to behavior derived from same rules and standards on valuation, risk and trading. Unlevel playing field is worth considering reflecting the unlevel capacity of financial institutions across the countries and within one country as claimed by the Warwick Commission. This is to facilitate the risk flow to where are best matched by risk capacity as claimed by the Warwick Commission. Diversity makes financial system more robust to shocks as witnessed by the strength of Thai (and Asian) financial system (See Table 5) in midst of ongoing crisis. Moreover, different structures of Thai banks at different of development may need slightly different sets of rules and guidelines for different context.

2.2 Credit Cycle & Crisis: Financial crashes are not random and always follow booms time as conjectured by the Warwick Commission. In the up cycle, prices based measured of asset values rise, price based measure of risk fall and banks appear. Bank's balance sheets expand with lower cost of

⁷ IAS 39 is the reporting standard stipulated by the International Accounting standard Board (IASB) to govern the accounting of derivative instruments based on "fair value" or "mark-to-market" based accounting. This is akin to its US counterpart, FSAS 133. The European Union (EU) has set a deadline of January 1, 05 for all publicly quoted firms - over 7,000 of them - in EU to adopt this standard. The controversy about IAS 39, particularly during the 2008 global credit crisis is discussed by Taka, Seko and Hoontrakul (2008).

funding and higher leverage. When the economic recession comes and triggers a rating downgrade, converge is true. Bank looks weak and risky. Chart 3 illustrates how credit extension by Thai banks fueled the boom in 1997 and crashed down in subsequent years. In a nutshell, bank credit extension growth rate is highly correlated with the nominal GDP growth rate.

Chart 3: Thai Banking System Loans to nominal GDP



FY07: 3Q annualized
Source: Bank of Thailand, Credit Suisse estimates

YoY growth: 3Q07 versus 3Q06
Source: Bank of Thailand, Credit Suisse estimates

Source: Credit Suisse (Jan 08)

Regulators themselves apply market based measures of risk for capital requirement. The new market based accounting like IAS 39 and price based risk measurement like Value at Risk (VaR) amplified this intensity as these measures are pro-cyclical in nature as discussed by Hoontrakul (2008). Counter-cyclical measures like Spanish dynamic provision policy and regulation flexibility may be needed as suggested by Saporata (2009) to smooth out this wide swing cycle. Furthermore, politicians like a prolong boom period, especially during the election time. The enactment of Financial Institutions Business Act in 2008 is a major step in the right direction. But it remains to be seen how efficient as well as effective the implementation will be for better CG for banking industry and for the benefit of the whole economy.

V. Conclusion:

Corporate governance (CG) in banking industry of Thailand has evolved significantly after the 1997 Asia Debacle. The crisis resolution is examined and set the stage in shaping new CG and banking landscape. The international standard such as OECD and BIS guidelines has been closely followed. Bank of Thailand (BoT) has continuously updated its regulation and best practice advice to reflect the changing financial environment.

The new Financial Institutions Business Act was enacted and became effective on Aug 3, 08. The Act that standardizes the different regulations governing commercial banks gives BoT an exclusive supervisory power over all types of financial institutions. This is another milestone for banking supervision strengthening the independence of central bank institution. But it remains to be seen how efficient as well as effective the implementation will be for better CG for banking industry and for the benefit of the whole economy.

Most banks are to follow the regulatory guidelines and advices, but it is doubtful that all these Western concept and practices are applicable to local context. In the wake of the 2008 Global Credit Crisis, some foods for thought are given and discussed for further improvement. Thai banking characteristics and local environment should be officially recognized. Its practical implication is a need to apply Western CG standards onto local context with clear strategic direction.

Family and state majority owned formation, oligopolistic market structure and dynamic complex asymmetric information between executive and stakeholders are among Thai banking characteristics that are different from the Western environment. Ownership structure of the banks matter considerably. Majority private own banks are the most efficient banks, while the wholly own SPS banks are the least. The majority state own banks are prone to CG problems because they are subjected to dynamic complex multiple principle and common agency issue. Going forward, there is a need for clear strategic direction understood and shared by all relevant parties.

Next a trade-off between micro and macro prudence is examined with one example cited. Finally, credit extension cycle and a need for more counter cyclical measures are discussed to improve stability and safety. Beyond that CG probably can prevent neither bad loan nor bubble, but it may limit the damage that might occur.

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ACRONYM

Abbreviation	Meaning	Description
ACL	ACL Bank Public Company Limited	a private bank in Thailand owned by Bangkok Bank Group on 2008 and transfer to MOF on 2009
AMC	Asset Management Company	A company that invests its clients' pooled fund into securities that match its declared financial objectives
BAAC	Bank for Agriculture and Agricultural Co-operatives	Special Purpose State Bank in Thailand
BAY	Bank of Ayudhya Public Company Limited	a private bank in Thailand owned by GE
BBC	Bangkok Bank of Commerce	Closed on 1997 due to liquidity problem
BBL	Bangkok Bank Public Company Limited	a private bank in Thailand owned by Sophonpanich Family
BIS	Bank for International Settlements	an institution, based in Basel, Switzerland, that accepts deposits, makes loans for national central banks, and assists in offsetting speculative movements of funds between the major currencies; set up in 1930
BoT	Bank of Thailand	Central Bank in Thailand
CDRAC	Corporate Debt Restructuring Committee	Public-Private Resolution for voluntary debt negotiation
CEO	Chief of Executive Officer	the corporate executive responsible for the operations of the firm; reports to a board of directors; may appoint other managers (including a president)
CG	Corporate Governance	The manner in which the stakeholders in a corporation relate to one another. Corporate governance has a positive connotation and a company with "good" corporate governance is said to be a company in which all stakeholders relate to each other in a positive way.
CIMBT	CIMB Thai Bank Public Company Limited	a private bank in Thailand owned by CMIB , Malaysian Group
FRA	Financial Sector Restructuring Authority	
FSB	Financial Stability Board	
GDP	Gross Domestic Product	the total market value of all final goods and services produced within a country in a given period of time (usually a calendar year).
GHB	Government Housing Bank	Special Purpose State Bank in Thailand
GSB	Government Saving Bank	Special Purpose State Bank in Thailand
IAS 39	International Accounting Standard 39	IAS 39 is the reporting standard stipulated by the International Accounting standard Board (IASB) to govern the accounting of derivative instruments based on "fair value" or "mark-to-market" based accounting.
IMF	International Monetary Fund	
IOD	Institute of Thai Directors	Thailand-based organisation, incorporated by SET to support, represent and set standards for company directors
KBANK	Kasikorn Bank Public Company Limited	a private bank in Thailand majority owned by Lamsam Family
KK	Kiatnakin Bank Public Company Limited	a private bank in Thailand majority owned by Kiatnakin Family
KTB	Krungthai Bank Public Company Limited	a state bank in Thailand majority owned by Ministry of Finance
LH	Land and House Bank Public Company Limited	a private bank in Thailand majority owned by Land and House Group

MOF	Ministry of Finance	
NPA	Non-performing Asset	A classification used by financial institutions that refer to loans that are in jeopardy of default. Also known as “non-performing loan”.
NPL	Non-performing Loan	a loan that is in default or close to being in default
OECD	Organization of Economic Corporation and Development	
SCB	Siam Commercial Bank Public Company Limited	a bank in Thailand majority owned by Crown Property Bureau
SCBT	Standard Charter Bank (Thailand)	a private bank in Thailand wholly owned by Standard Charter Bank Group
SCIB	Siam City Bank Public Company Limited	a state bank in Thailand majority owned by Bank of Thailand
SEC	Securities and Exchange Commission	a Thai agency to supervise public company and regulate issues of and transactions in securities and to prosecute illegal stock manipulations
SET	Securities Exchange of Thailand	
SME Bank	Bank for Small and Medium Enterprise	Special Purpose State Bank in Thailand
SPS Bank	Special Purposed State Bank	legal entity wholly owned by state created to fulfill narrow, specific or temporary objectives for public welfare
TAMC	Thailand Asset Management Company	a centralized agency is created by Thai government to take over all banks' NPLs during 1997 financial crisis
Tbank	Thanachart Bank Public Company Limited	a private bank in Thailand majority owned by Thanachart Capital Group Joint Venture with Bank of Nova Scotia
TISCO Bank	TISCO Bank Public Company Limited	a private bank in Thailand majority owned by TISCO Financial Group
TMB	Thai Military Bank Public Company Limited	a state bank in Thailand majority owned by Ministry of Finance and Joint Venture with ING Group
UOBT	United Oversea Bank (Thailand) Public Company Limited	a private bank in Thailand wholly owned by UOB Group, Singapore
VaR	Value at Risk	the maximum loss not exceeded with a given probability defined as the confidence level, over a given period of time. It is commonly used by security houses or investment banks to measure the market risk of their asset portfolios (market value at risk), however VaR is a very general concept that has broad applications. VaR is widely applied in finance for quantitative risk management for many types of risks. VaR does not give any information about the severity of loss by which it is exceeded. Other measures of risk include volatility/standard deviation, semivariance (or downside risk) and expected shortfall.