



**Papers and Proceedings**  
**The Eighth Annual Conference**  
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**July 22-25, 2001**

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### **Asia Pacific Finance Association**

The Asia Pacific Finance Association (APFA) was created in 1993 to promote academic financial research (especially relating to the Asia Pacific region) to disseminate its findings and to facilitate the exchange of information, ideas and staff among educators and between business executives and academic through conferences and publications. APFA is modelled after the American Finance Association and the European Finance Association.

*David Walker and Pongsak Hoontrakul*  
**Transitioning from Blanket to Limited Deposit  
Guarantees: Thailand Policy Considerations**

**ABSTRACT**<sup>1</sup>

In the aftermath of the 1997 crisis, many Asian countries such as Thailand are examining options for transitioning from blanket deposit guarantees to more limited and explicit deposit insurance systems [DIS]. Though the need to reduce blanket guarantees and their associated costs is well understood, it is critical for Thailand that this transitioning process be effectively managed and that a well designed explicit DIS be introduced. The full implementation of a DIS should only be undertaken when the banking system returns to normalcy and the financial and economic environment is conducive. Otherwise, transitioning could be a **potentially dangerous proposition** leading to increased bank fragility, 'capital flight' and a fertile ground for moral hazard and other agency problems. The key questions are how to manage the transition process in a timely, orderly and constructive manner and how to design an incentive compatible DIS for all bank stakeholders.

Transitioning to a DIS should be seen as an integral component of a country's overall financial sector reform strategy. Transitioning is fundamentally a **dynamic, trust building, process-oriented management problem** as inferred by Chaipravat and Hoontrakul (2001). It is critical also when designing a DIS to effectively balance the dual conflicting goals of (1) protecting less-financially sophisticated depositors and contributing to financial stability and (2) minimizing bank incentives to take excessive risk. In this paper, after taking into account Thailand's unique banking system structure - highly concentrated in both banks and large depositors - an innovative two-tier hybrid DIS model is proposed. A publicly administered **compulsory** system would provide protection for **low coverage level** bank deposits (i.e. similar to an FDIC, CDIC approach) and a private/public system akin to that used in Germany would provide additional protection for **high coverage level** bank deposits on **voluntary** basis. Some rules-based check lists, policy recommendations and implication issues are presented.

*'An ounce of prevention is worth a pound of cure.'*

*Benjamin Franklin*

### Introduction

Thailand and a number of other countries in Asia introduced explicit blanket deposit guarantees to help deal with their systemic financial crisis during 1997. While some debate the long-term implications of using blanket deposit guarantees in the resolution and recovery from the Asian financial crisis, these guarantees clearly contributed to keeping troubled institutions afloat, improving confidence and contributing to overall financial system stability. Stability was further assisted in most countries by the injection of massive liquidity into their financial systems by their respective monetary authorities. Undoubtedly without the blanket guarantees the

clean up and recovery process would have taken longer and the costs would have been considerably higher.

As the after effects of the Asian financial crisis seem to recede, many countries which relied on blanket guarantees are examining options for

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transitioning towards more limited protection in the form of explicit deposit insurance.<sup>2</sup> In order for this transitioning process to be successful at balancing the objectives of protecting less-financially sophisticated depositors and contributing to system stability with the need to introduce greater market discipline and incentive compatibility, it should be recognized that transitioning is fundamentally akin to a dynamic trust building process-oriented management problem. And, that it is part of the broader transition process from a dysfunctional to a normal banking system as described by Chaipravat and Hoontrakul (2001). This is due to the multi-dimensional and dynamic complexity of the transition problems facing decision makers. In this context, success will be dependent on understanding the integral nature of transitioning and the need to address all stakeholder issues in such a way as to promote economic and financial stability, growth, trust and credibility. It is also vital to recognize that when transitioning from blanket deposit guarantees to an explicit limited deposit insurance system (hereafter referred to as a 'DIS') care must be taken. Eliminating guarantees and introducing a poorly designed DIS into a weak and unstable financial system with poor supervision, regulation, legal and other institutional arrangements can have serious negative consequences. Failing to offer credible guarantees and thus avoiding 'runs'; exacerbating moral hazard problems; and contributing to the dilemma of 'regulatory and political capture' are some of the potential pitfalls.<sup>3</sup>

This paper begins with a discussion of background issues related to the Thai financial crisis and the use of blanket guarantees. Section I and II explore macro and micro systemic issues in Thailand which need to be addressed in a dynamically efficient way prior to transitioning. Section III sets forth a proposal for an incentive compatible two-tier hybrid DIS model which takes into account Thailand's unique banking system characteristics.

### **Background: The Thai Financial Crisis and Blanket Guarantees**

Though a difficult and expensive choice, regulators often elect to be the *'insurer of last resort'*.

<sup>2</sup> Deposit protection systems, also commonly referred to as deposit insurance, represent a guarantee that all or a limited amount of the principal and interest accrued on protected accounts will be paid. The guarantee can range from being explicitly offered in law or regulation or offered privately with or without government backing or enabling legislation.

<sup>3</sup> See Caprio et al (World Bank, 2001)

by issuing a full and temporary blanket guarantee rather than risk complete collapse of the financial system in a crisis.<sup>4</sup> The costs of the blanket guarantee represent a large contingent liability for the issuing government and a cost that cannot be known *ex ante* but is promptly needed to maximize *ex post* social welfare. Longer-term costs tend to be more serious such as a reduction in market discipline. This can occur if bank owners and managers view the guarantees as a license to take excessive risks and for depositors to exercise less caution than otherwise with regards to where they place their funds. Though not stated explicitly when the guarantee is initially offered, regulators often have the desire to reduce the guarantee over time to reduce the long-term costs associated with blanket guarantees. Thus, a common option for many countries in these circumstances is to transition to a limited explicit DIS.<sup>5</sup>

Other potential problems relate to accountability issues in that the blanket guarantees may be used to *mask* problems in government economic and financial sector policy which often are at the root cause of many financial crises. For instance, blanket guarantees can provide a *false sense* of security to supervisory authorities in a crisis and may reduce incentives for financial sector reforms. The crudeness of this intervention policy is that it has little or no responsiveness to soft information such as incremental NPL changes, sliding banking system net worth and other factors such as those suggested by Dewatripoint and Tirole (1994, chpt. 11-12).<sup>6</sup>

The government of Thailand introduced blanket guarantees in June 1997 in response to problems with a number of finance companies (Table 1 contains a detailed chronology of the key events in the Thai financial crisis). The initial announcement saw the extension of blanket guarantees to all foreign and domestic depositors and creditors of finance companies, although the initial finance company depositors were not covered by the blanket guarantee and did experience losses. The current guarantee structure

<sup>4</sup> Lindgren et al. (1999), Nukul Report (2000, pp. 121-126, 140-146) and Allen and Gale (2000)

<sup>5</sup> Despite some controversy over the merits of explicit limited deposit insurance systems, they are seen by many countries as an acceptable alternative to blanket guarantees and implicit protection. When well designed and integrated with other features of the financial system safety net, deposit insurance can be an effective way to balance the stabilizing benefits of guarantees while minimizing the government's exposure to loss, moral hazard and adverse selection costs associated with guarantees.

<sup>6</sup> More discussion by Hoontrakul (1997), Nukul Report (2000) and Chaipravat and Hoontrakul (2001).

provides for immediate payouts for short-term deposit holders. Longer-term deposit holders are provided with staggered repayment schedules depending on the terms of deposits. Part of the costs associated with paying-off depositors is borne by the banks which are required to provide levies to the government.

Beginning in October 1997, the Ministry of Finance (MoF) and the Bank of Thailand (BoT) outlined plans to address the crisis with specific measures for financial sector restructuring. The Financial Restructuring Agency (FRA) was created; amendments were made to the original 1985 Commercial Banking Act and to the Finance Company Act, giving the BoT additional powers to order capital reductions, capital increases, and changes in management structure for banks and security companies. The new measures established an asset management company to address the asset problems of suspended finance companies. Additional reforms of the Thai commercial code and bankruptcy laws have been initiated and the government is establishing a new supervisory framework and accounting and disclosure rules.

Nonetheless, financial institutions in Thailand continue to be plagued by weak capitalization, high levels of non-performing loans (NPLs) and poor earnings. Chairpravat and Hoontrakul (2001) conjecture that credit extension remains a serious problem and it is very difficult to see how Thailand can recover economically on a sustainable level if the banking system remains dysfunctional. Chairpravat and Hoontrakul extensively discuss and Allen (2001) supports the critical significance of banking in economic development for emerging and imperfect markets based on agriculture and traditional manufacturing. Thus, the Thai government should as a principal first endow agents with trust capital in the form of limited, but contestable, banking competition, partial credit guarantee schemes and demand side intervention in terms of value added business activities. To minimize 'common agency and multiple principals' problems, state-owned and newly nationalized banks should focus on narrow types of banking activities. As Chairpravat and Hoontrakul argue, it is desirable for Thailand's banking system to be strengthened by temporarily accumulating oligopolistic and policy-induced rents and later on building up reputational and informational capital.

## Section I: Macro issues in transitioning

One of the first steps involved in creating *favourable* conditions for a successful transition from blanket guarantees to a DIS involves dealing with macroeconomic issues. Underlying systemic macro issues, in particular those factors which have a direct link to the financial sector must be dealt with first in a dynamically efficient way. Although it is understood that in many cases conditions will never be perfect, it is important to have a process to evaluate what are the current macro conditions, what are acceptable conditions or trigger points for moving ahead; and what steps need to be taken in the meantime to address problems.<sup>7</sup>

Major economic indicators for Thailand locally as well as internationally are presented in Table 2. On the surface, *backward looking* views suggest that the economy has bottomed out and on the path of recovery after the 1997 baht floatation. Real economic growth improved during 1998-2000. The exchange rate has been relatively stable at around 42 bahts per US\$ during the last two years. Despite the initial adverse inflationary impact from de facto baht devaluation in 1997-8 and a surge in oil prices in the last year, consumer price inflation remains subdued and below the World CPI. Thailand's current account, external debt positions, and international reserves have improved markedly in recent years. In other words, GNP/GDP enjoyed a brief bounce back in 1999 to 2000 utilizing excess export capacity as conjectured by Chairpravat and Hoontrakul (2001). Private sector investment began moving forward in 2000 although the recovery appears somewhat precarious. Nevertheless, while progress has been made, it is still too early to declare a full return to macroeconomic stability.

On the *forward looking* perspective, the financial and economic outlook appears fragile. World real GDP in 2001 is forecasted to grow at less than half the rate of 2000 in light of the U.S. slowdown and the poor economic outlook for Japan and Europe. Consequently, growth in Thailand's GDP and exports are likely to contract this year. *On the production side*, both agriculture and non-agriculture sectors are expected to experience slow growth although the service sector may fair better. *On the financial side*, the interbank rate has increased by design from changes in BoT policy. The exchange rate, by default, may face a

<sup>7</sup> See Working Group on Deposit Insurance, Discussion Paper on Situational Analysis and Implementation Considerations (2001).

potentially turbulent period on the back of possible contagion effects from Latin America and neighboring countries and from domestic fiscal imbalances. The extension of total bank credit is not expected to improve and may contract in the foreseeable future. As discussed by Chaipravat and Hoontrakul (2000,2001), unless banks start to lend more and generate sustainable net operating profits, eliminating blanket guarantees at this time could further exacerbate banking system problems.

On a more positive note, the emphasis of the central bank of late has been on micro initiatives as recommended by Chaipravat and Hoontrakul (2001). Promoting the growth of small and medium enterprises (SMEs) and providing liquidity at the grass roots level. This should help revive bank lending, make progress against the NPL problem, and otherwise deal with financial and corporate sector restructuring issues. Thailand's macroeconomic situation should also benefit from proposals to expand ASEAN swap arrangements arising from the Chieng Mei initiative as proposed by Chaipravat and Bhanich Supapol (2000).

A key question facing policymakers concerned with transitioning is whether or not the current conditions are acceptable. In the case of Thailand, it would be desirable to observe at least two historical quarters and two projected quarters with annual real GDP growth in the range of 2.5 to 5%; the presence of low inflation relative to World CPI; rising real wages and steady increases in private investment and consumption. On the financial side, the trigger points should include: relatively stable interest rates and exchange rates and growth in total credit and bank earnings. Current data suggest that Thailand is near these thresholds.

## Section II : Micro Issues in Transitioning

At the same time as macro conditions are being dealt with, attention should be focused on micro issues. This involves (1) assessing financial sector structure and stability conditions; (2) designing a transparent and credible timetable and sequence for implementing the transition; and (3) addressing the required structural and institutional reforms necessary to strengthen the financial sector and build overall stability, trust and credibility.<sup>8</sup>

<sup>8</sup> See FSF Working Group on Deposit Insurance, Discussion Paper on Transitioning (2001).

## 2.1 Stability of the Banking System

It is important to evaluate the state of the banking system when considering transitioning. If the banking system is still characterized by severe problems and depositor confidence has not improved appreciably, then transitioning to limited guarantees is likely to further de-stabilize the system.<sup>9</sup> Stability triggers which need to be assessed in order to gauge the appropriate time for transition include ensuring: the containment of systemic risks, improving confidence levels, capital adequacy and improving asset quality, and sustained increases in credit and deposit growth.

As mentioned previously, before the 1997 financial crisis first began, Thai authorities moved rapidly to protect the financial system. Starting with clandestine liquidity support in early 1997, through the rapid closure of 58 finance companies, and extension of the blanket guarantees, the Thai authorities attempted to reassure markets, creditors, and depositors about the integrity of the financial system. However, despite success at containing systemic risks, improving confidence levels, and re-structuring of the financial sector, (see Tables 4 and 5), the Thai financial system remains weak and further progress has been slow. The surviving Thai banks and finance companies are generally marked by high levels of NPLs (down from 43% in 1997 to 17.7% of total loans as of 2000); poor earnings and returns on equity and assets and improving but still weak capital positions.<sup>10</sup> Deposit growth has resumed but credit growth remains quite weak - particularly with regards to the extension of credit to SMEs.

Many feel the authorities have not moved fast enough to force banks to clean up their problem loans. Initially, the banks were encouraged to create their own asset management companies (rather than a central, national AMC) and several of the largest banks have already done so. However, recent initiatives to centralize the management of AMCs appear promising and should help to accelerate banking and corporate restructuring and asset disposition, Klingebiel (2000). Chaipravat and Hoontrakul [2001, p. 29] suggest that using such an *ex post* one time stock concept of assistance to shore up bank balance sheets is a necessary but not sufficient condition to address these problems. This requires utilizing

<sup>9</sup> See Garcia (2000).

<sup>10</sup> Although NPLs have declined significantly in Thailand from around 50% in 1998 to around 18% as of 2001, a significant portion of the improvement appears to be due to the transfer of non-performing assets to AMCs.

more of an 'off-balance' sheet, *ex ante* flow concept of income and wealth generation which better shares risks and rewards among stakeholders. One way this could be accomplished is through the participation of the government in risk sharing to promote the extension of credit, particularly to the SMEs sector, through loan guarantees.

## 2.2 Timing and Sequencing

Key timing and sequencing issues to consider include whether to use a 'fast track' or 'phased-in' (gradual) approach and the appropriate sequencing of transitioning initiatives. Experience suggests that a fast track approach can yield important benefits such as avoiding the entrenchment of the blanket guarantees. However, a fast track processes requires that a country's underlying conditions are in a process of recovery and that institutional reforms are progressing well. It also requires that the government's actions are viewed by the public as being highly credible and that stakeholder opposition to its plans is limited.<sup>11</sup> In the case of Thailand, preparations for transition have been underway for some time and appear coordinated with other macro and micro institutional reforms. Nevertheless, a gradual approach to eliminating the blanket guarantees and introducing a DIS appears warranted (i.e. in the range of 2-4 years) in Thailand's case.

## 2.3 Other Structural and Institutional Reforms

One of the first operational tasks involved in transitioning is the creation of a formal institutional structure to coordinate all aspects of the transition process from blanket guarantees with other structural reforms. This recognizes that transitioning is integral to other economic and financial sector reforms and that a well-coordinated approach to address all stakeholder needs has to be addressed. A variety of structures are available including having a single entity control and coordinate all aspects of the process to a coordinated effort among existing agencies. As mentioned previously, this was a weakness in the Thai financial system prior to the crisis. However, whatever organizational structure is selected it is important to ensure that the coordinating entity(ies) have a clearly defined mandate, appropriate legislative authority,

<sup>11</sup> For example, Korea moved quickly to reduce its blanket guarantees by reducing full coverage of interest to principal only in 1998. On the other end of the spectrum, Japan and Mexico have announced detailed and drawn-out schedules for removing their blanket guarantees over a number of years.

credibility, expertise, and appropriate financial and human resources.<sup>12</sup>

After the crisis, the government moved quickly to create several special organizations to undertake the clean-up. The Financial Restructuring Authority (FRA) was established in October 1997 and charged with liquidating the shuttered finance companies.<sup>13</sup> The BoT set up the Corporate Debt Restructuring Advisory Committee (CDRAC) to play a facilitating role between debtors and creditors and aid the restructuring process. Through new legislation, strengthening and clarifying their powers, the BoT as well as the MoF will continue to take the leading roles in the restructuring efforts. In the specific case of deposit insurance, the implementation and transitioning issues are under active study by the BoT.

### Legal framework

It is important to assess the degree to which appropriate legislative and legal frameworks are in place when considering transitioning. Important characteristics of a sound legal environment are that it is well-defined, supportive of financial reporting and facilitates the early detection of problems and their prompt correction. It is particularly desirable to have legislation in place to allow banks to be closed before they become deeply insolvent in order to minimize costs associated with failures. A legal environment which provides for a clear and orderly liquidation of assets, a priority system for creditor claims and a mechanism for the resolution of claims is also desirable. Finally, a critical element of any sound legal framework is the ability and willingness to enforce the law.

As mentioned in the preceding section, legal and legislative reforms in Thailand are well underway. Bankruptcy law revisions have created a separate bankruptcy court with appropriate powers and procedures for reorganization under bankruptcy protection. In addition, a series of "business reform laws" were passed through the Thai Parliament beginning in early 1999 which, among other things, were designed to address shortcomings in the civil code, covering commercial activities. The government has also enacted reforms to loosen foreign ownership restrictions for banks and property. Table 6 lists 11 important reform laws that were recently enacted. Despite these improvements, the reorganization procedures stand to be even longer

<sup>12</sup> See FSF Working Group on Deposit Insurance, Discussion Paper on Transitioning (2001).

<sup>13</sup> See more discussion by Manivat et al (1999).

and more complicated than the restrictive old laws and the new regime has exposed the need for additional reforms in commercial law (for example, laws dealing with collateral, priority in claims, foreclosure on collateral and others). Further enhancements to the legal system along these lines are currently underway.

In terms of trigger mechanisms, it appears that a suitable degree of progress has already occurred to reinforce other structural reforms. However, it will be important in the future to continue with reforms. In addition, actual legal foundations need to begin to be constructed to establish a DIS.

#### *Prudential regulation and supervision*

A key element in assessing country conditions is the need to look at the state of prudential regulation and supervision as this will act as a major force to control moral hazard and ensure safety and soundness.<sup>14</sup> To gauge the effectiveness of the regulatory and supervisory system, and gaps between existing and ideal conditions, it is helpful to compare with suitable international standards and approaches.<sup>15</sup>

In Thailand, supervisory standards have been strengthened through a series of measures implemented since August 1998. Although new asset classifications were created, provisioning requirements strengthened and disclosure enhanced it has been a challenge for the banks to meet the new standards while trying to rebuild their balance sheets. To help support a return to 'normalcy', the supervising authorities reduced the liquidity reserve requirement and allowed restructured loans to be reclassified. The August 1998 Package also included a capital support scheme to assist with capital raising. It is hoped that the newly established Thailand Asset Management Corporation (TAMC) will help ease NPLs.

New regulations were also developed to strengthen the prudential framework. Before the crisis, though Thailand had a reasonably thorough set of financial system supervisory regulations, regulations were not complete and there were

also weaknesses in their implementation.<sup>16</sup> For example, Loan classification, accounting, and provisioning rules were inconsistently applied; Banks could 'restructure' problem loans and not reclassify the loans; Banks could still accrue interest on non-performing loans, overstating bank earnings and limitation for micro-risk concentration in specific sectors.

In addition, powers and supervisory authorities were fragmented. Though the MoF has the responsibility of overseeing the financial system, the BoT was given the task of day-to-day supervision. The MoF had the power to issue, suspend or revoke the operating licenses needed for banks and security companies as well as the power to intervene in any troubled financial institution. After the crisis began, authorities moved to implement a series of restructuring and reform measures. For example, the emergency decrees announced on 24 October 1997<sup>17</sup> amended the governing regulations for banks and finance companies and gave the BoT greater powers<sup>18</sup>. The decrees also established the FRA and asset management companies. In sum, given a critical mass of the supervisory and regulatory reforms have been either initiated or are in process, there appears to be an adequate framework to support the introduction of more limited DIS.

#### *Information and public awareness*

Market and general public attitudes and expectations regarding the financial sector play a very important role in transitioning. Generally, the better the information that is disclosed by institutions the more effective is market discipline and the effectiveness of a DIS. Efforts to promote greater information flows from banks to fund users and fund providers is particularly important for Thailand as financial markets and credit markets have historically been characterized by incomplete, insufficient and asymmetric information problems. In terms of providing information to the general public, the more aligned the transitioning process is to public attitudes and expectation the more likely the system will be effective. Therefore, it is important to gather information on exactly where deposits are located, deposit growth and the size, destination and distribution of deposits. In addition, an analysis of public awareness and attitudes towards guarantees prior to the commencement can also help in transition planning and implementation.

<sup>14</sup> See Garcia (1996).

<sup>15</sup> For example, the Basel Core Principles of Financial Supervision and Regulation, IOSCO Principles of Securities Regulation, IAIS Insurance Core Principles, Core Principles for Systemically Important Payment Systems, and the Code of Good Practices on Transparency in Monetary and Financial Policies.

<sup>16</sup> Lindgren et al. (1999), p. 94: Appendix V.

<sup>17</sup> Lindgren et al. (1999), p. 96: Appendix V.

<sup>18</sup> The Bank of Thailand can now order capital increases, capital reductions, and changes in management for troubled financial institutions.

Obviously the presence of a growing and widespread domestic deposit base coupled with improving confidence levels in the banking system are highly desirable features.

Thought should be given to announcing to the public as early as possible any changes to the terms and conditions of coverage. In recognition that public attitudes and actions can change during the process of transitioning it is also imperative to ensure that the public awareness initiatives constantly monitor attitudes, expectations and changes in deposits and be able to respond effectively if required. In this respect, the BoT needs to urgently begin addressing public awareness issues more extensively through the media.

### Section III: Incentive Compatible Designed Two-Tier DIS for Thailand

Provided fundamental macro and micro transitional issues are dealt with, the next consideration is to design an incentive compatible DIS for Thailand. It should be recognized that the design of a DIS should conform to Thailand's unique banking structure and be consistent with public policy objectives such as the protection of less-financially sophisticated depositors and contributing to financial system stability as suggested by the Working Group on Deposit Insurance (2001), Beck (2000) and Garcia (2000). Other considerations involve making sure that the main design features (i.e. membership, coverage, funding, powers, and structure) minimize bank incentives to take excessive risks. Design features need to reflect the needs of all stakeholders in a way which builds trust and credibility. These objectives and considerations should serve as a general guide for the development of a Thailand Deposit Insurance Corporation (TDIC).

#### 1. Thailand's Unique Banking Structure Is A Major Issue:

The structure of the financial system can not be overemphasized when considering transitions. In Thailand, concentration in the banking/finance sector has increased as a result of the financial crisis (see Tables 4 and 5). Before the crisis, the Thai financial system had relatively few large banks characterized by an oligopolistic industry, but a highly fragmented large number of deposit-taking finance companies. After the crisis, the banking industry became even more concentrated. Most small and medium size banks did not survive. Out of more than 90 finance companies in operation before the crisis, only 22 survived as

of June 2001. The few remaining finance companies are expected to merge into restricted banks.

The ownership structure of the industry has also changed considerably since 1997. The importance of private commercial banks and finance companies has declined in terms of total assets while state-controlled institutions and foreign owned institutions have increased significantly. Moreover, before the crisis, out of a total of 15 Thai banks, several of the top banks were family owned or controlled while others were connected directly or indirectly to the government or national institutions. Thus, the Thai commercial banking system is now roughly half owned by the public and the rest by the private sector.

In large part, this reflects the policy of the government to promote stability through consolidation. One consequence of this is reduced competition among domestic deposit-taking institutions, although foreign bank entry has expanded and markets remain contestable as suggested by Chaipravat and Hoontrakul (2001). Another consequence is that in providing a DIS policymakers will be the need to control for moral hazard in the concentrated banking system. While supervision and regulation will play a large role, reliance on private-sector instruments to foster market discipline such as cross-equity holdings among large banks and sub-debt instruments can also be useful.

Another intriguing part of the banking structure in Thailand is the structure of fund providers or depositors as analyzed by Chaipravat and Hoontrakul (2001, p. 25). The breakdown of deposit classification by size is given in Table 7. This data shows that Thailand's banking system is heavily funded by a relatively small number of large depositors, similar to many other emerging markets.<sup>19</sup>

#### 3.2. Outline Framework for Deposit Insurance in Thailand

In simplistic form, *banks* take 'deposits', make loans, charge borrowers 'interest' and share it with 'depositors'. *Life insurers* or pension fund managers receive a 'premium' or 'contribution', invest them in 'relatively risk free' securities and share the investment returns with 'policy holders' or 'plan members' in the form of 'annuities or endowments'. Banks and life

<sup>19</sup> In 2000, about 1.5% of total deposit accounts in Thailand represented more than 80% of all cash deposits.

insurance firms are alike in terms of pooling individual risk and resources and benefit some from diversified portfolios with 'long life institution perception advantages'. As a result, private banks and insurers can 'cherry pick' when lending or insuring parties to limit their risk. In contrast to traditional banking and insurance, however, losses on bank failures for an explicit DIS are normally not independent and usually occur in waves because all banks are exposed to macro and micro risks to some degree. As with traditional insurance, a TDIC may perform well if one or a small number of mismanaged banks fail. The depositors can be paid off quickly and the ill-fated bank assets can be liquidated and administered for a bank resolution. In the case of widespread systemic crises, other elements of the safety-net need to be coordinated with the DIS to restore stability.

However, given a highly concentrated banking system such as Thailand's, a TDIC may be exposed to catastrophic or *systemic risk* if even one large bank fails. This potential macro risk (which is difficult to diversify given Thailand's small open economy) can make TDIC more vulnerable to exogenous (and endogenous) macro economic shocks similar to the 1997 crisis. In such instances, bank resolution can be quite complex and fraught with dynamic issue problems such as moral hazard, 'regulatory and political capture' and agency problems.

Beck (2000) describes extensively and evaluates in a micro economic sense the history of the German DIS managed in a 'private club nature'. In essence, this *voluntary* scheme for private commercial banks (one of several operating in Germany) with virtually unlimited guarantees is *privately managed and privately funded* without any government supervision.<sup>20</sup> As a matter of fact, the Bundesbank is legally *prohibited* to act as a lender of the last resort and the private DIS has no statutory support. Close cooperation between public officials and private bankers, *peer monitoring* and the independent audit and supervisory power of the scheme have contributed heavily to the success of German system and off-set incentive-incompatible elements. Beck concludes the success of the scheme depends heavily on the existence of a very concentrated banking market, strong corporate governance arrangements and an anti-bankruptcy institutional bias. Moreover, large shareholders of German private banks are subject also to calls to make due all debt and liabilities of banks in distress — basically a form of 'double

<sup>20</sup> It is important to note, however, that due to the implementation of the European Union Directive on Deposit Insurance membership in the scheme is now compulsory.

liability'. Note that many of these institutional arrangements are absent from the Thai case but could be considered when designing a DIS.

On the other hand, Garcia (1999, p. 9) focuses on recommended *good practices* for an explicit DIS in *normal* times. Garcia's recommendations are primarily aimed at banking systems with low-to-medium concentration and aim to solve microeconomic problems in adverse selection, moral hazard and agency problems among other issues. Garcia emphasizes the need for incentive design, compulsory membership, funding premium schemes, publicly-oriented management structures and the use of market oriented discipline where possible. However, Caprio et al (2001, p. 110) asserts that, except in the German case, the explicit DIS cases which Garcia examines, are *positively* correlated, on average, with banking crises. It should be noted, however, that Caprio's data set is heavily weighted with country data from weak institutional environments and which have poorly designed explicit schemes. In countries with well designed systems and sound institutional structures this is not generally the case. Work by Gropp and Vesala (2001) and findings of the Working Group on Deposit Insurance (2001) also come to this conclusion. Nevertheless, it can not be overemphasized that both explicit and implicit guarantees can induce risk-taking and destabilize banking system, especially in weak institutional environments and when DIS is poorly designed (See Caprio (pp.110-1), Eichengreen and Arteta (2000, pp. 44-45) and Garcia (pp. 4, 7-8, 14-15).

In short, approaches advocated by Beck and Garcia have their merits and drawbacks depending on the market microstructure and stakeholder behavior in country specific settings. In light of this and given Thailand's unique banking system attributes, we propose a hybrid two-tier approach to DIS for Thailand - a *publicly* administered TDIC system providing *compulsory low* coverage for small deposits and a *public/private* system with compulsory membership providing additional levels of coverage (at the discretion of the bank) for *large* depositors utilizing various attributes of the German DIS scheme for private banks.

### 3.3 Trust Building for Deposit Insurance in Thailand

As stated previously, while Thailand's banking system is strengthening, the BoT and MoF should seek to endow trust capital and build infrastructure. This can be accomplished through the following approach:

3.3.1 *Trust Capital Endowment: the Role of Government:* One vital lesson learned from the 1997 crisis is the danger of not having an independent agency for banking resolution. During the 1997 crisis up until now (August, 2001), the BoT administrated both macro and micro risk from at least three separate departments inside its own central bank. The three conflicting responsibilities are as 1) guardian of monetary policy; 2) lender of last resort; 3) supervising banks, and running BoT's de facto DIS — via the Financial Institutions Development Fund (FIDF)<sup>21</sup> These functions are very difficult to separate, particularly in time of crisis as noted by Garcia (1999, p. 23). Accountability for each responsibility and for each individual response is very difficult to assess as evidenced by Nukul (2000). Thus, we propose the following solution.

Independent Thailand Deposit Insurance Corporation [TDIC]: We support Chaipravat and Hoontrakul's (2001, p. 47) proposal to split the BoT into two independent units - one for micro banking risk by establishing a TDIC and the other for macro monetary policy. Though the power to print money and the ultimate power of lender-of-last resort would remain with the BoT governor, the director of the TDIC would have full independent legal powers to examine, regulate, close down and resolve problem banks. All the assets and liabilities and sources of funding from the FIDF of the BoT would be completely transferred to the TDIC along with necessary expertise and human capital. All present and future premiums on deposits would be transferred to the TDIC account.

Liquidity Consortium Bank (LCB) - A Private and Public Partnership Initiative: Roughly half the of 20 bb premium proceeds of the first two years of TDIC's existence could be redistributed back to each individual contributing bank in the form of equity participation of one newly nationalized medium size bank. In effect, this medium sized bank would be privatized with paid up capital of 20 bb in two years. LCB would be turned into a narrow bank performing as a second, independent, private-public partnership, de facto deposit insurer. Similar to the German system, the state owned bank and the top five private banks would take 40% and 30% of the newly defined LCB respectively. And the remaining equity would be shared among small banks and finance companies - foreign and domestic. To further strengthen LCB's financial

<sup>21</sup> See more discussion on the FIDF, BoT's micro banking and macro monetary policy at Chaipravat and Hoontrakul (2001, p. 47 and footnote 33) and Hirunwong (1999).

position, LCB would have access to a rediscount line and credit guarantee line on its debenture issuance from BoT equal to its paid up capital for each line.

3.3.2 *Trust Capital Building for the Role of TDIC:* To minimize 'common agency and multiple principals' problems, TDIC's mandate would be defined *narrowly* with a mostly rule-based approach with some of the following features:

Compulsory Low Coverage Insurer: The TDIC would be the compulsory low coverage insurer for all deposit-taking institutions - foreign or domestic, state or private. TDIC would unconditionally and promptly reimburse low (maximum coverage of 100,000 baht per depositor in domestic currency) in case of a bank failure. This should cover about 90% of depositors and account for about 10% of total deposits.

In terms of transitioning, the sequencing of the transition to the ultimate level of coverage is crucial. In cases where the economic recovery process and institutional reforms move in stages it is best to reduce coverage in a similar manner. In order to deal with the inevitable resistance and confidence issues that can incurred from large creditors *a process of 'grandfathering'* can be used — whereby full coverage is extended for the full term of deposits made prior to a specified transition date. Depositors are informed that all new deposits after the specified date will only be covered up to specified limits. Another very important element in transitioning is to clearly communicate to the public and other stakeholders changes in the scope and level of coverage.

Rule Based Power to Levy for TDIC: TDIC should have a rule based power to collect premiums and levies. For example, TDIC could charge an *ex-ante flat fee* 0.2% on the total deposit base of a member after the second year of establishment. The fee would be collected until some target level of insured deposits is reached. Second, TDIC should be able to impose *ex post* additional levies on the surviving banks when depositors in failed bank need to be compensated (as in Switzerland and the UK). More *ex post* levies could be imposed, if needed, as recommended by LCB and subject to BoT approval.

Rule-Based Power Trigger for Non-Financial and Financial Assistance: Any deposit taking institution which borrows more than half of its paid up capital in the interbank market or LCB more than any 5 working days in a month would

trigger a TDIC power for non-financial assistance if daily borrowing exceeded paid up capital in any given day. TDIC would have full authority to exercise its powers (e.g. bank closure, bail-out, director removal, etc.) in the FIDF Act, the Banking Act and the Finance Company Act. In short, this rule-based approach provides a justification for the authority to pursue remedial action in a proactive manner.

Close Cooperation and Information Sharing between TDIC and LCB: In order to promote information sharing and coordinated decision-making, we propose that a Board of Directors for TDIC be comprised of 1 chairperson, 2 persons each from the BoT and MoF, and that room be made available for independent third party representation. Furthermore, members from the Thai Bankers Association and Foreign Bank Associations could serve as members of a 'Super Advisory Body' to the TDIC and LCB. In addition to these governance arrangements, off-site and on-site supervision and audit would be done on a regular basis for all deposit-taking institution members. All pertinent information on individual members would be collected and stored in a centralized data base for the TDIC, BoT, MoF and LCB. Appropriate information on individual banks would be disclosed via web sites and other relevant means to the public on a timely basis.

BoT as a Sole Lender-of-Last-Resource: TDIC would be legally prohibited from providing lender-of-resort facilities.<sup>22</sup> All profits or access cash would be transferred to the BoT as TDIC reserve earnings at market interest rates. But, the TDIC would have the legal right to back-up funding from the BoT at a 'credit enhancement fee' similar to that used in the Canadian DIS scheme.

3.3.3 *Trust Capital Building - the Role of Liquidity Consortium Bank (LCB):* By construction, LCB would be designed as a narrow, commercial, profit-making private bank. It would take deposits, issues bonds, lend to its members and invest in relatively safe domestic and foreign assets. Its twin responsibilities to its members would be as a preferred liquidity provider and a high coverage insurer. The sharing of ownership among all banks is designed to create a sense of community, common goals and professional ethics similar to that in Germany. Other appealing features include:

<sup>22</sup> It is intriguing to learn that similar to Thailand's experience during the 1997 crisis, US congressional staff found that 90 percent of the extended credit granted by the central bank as the lender-of-last-resources went to banks which subsequently failed (U.S. House of Representatives, 1991, p. 94).

Compulsory membership for LCB but voluntary high coverage limits: Though LCB membership and the initial equity participation would be legally required by BoT regulation for endowment purposes, each bank and finance firm member would be free to choose their level of participation in the LCB. However, due to a high concentration of large depositors it is expected that most members would seek to have a coverage level up to at least 1 million baht from the LCB. Made-to-order high coverage arrangements in excess of this level would be available. State owned banks would be required to join the scheme and be subject to all its requirements.

Funding and premiums: As mentioned earlier, initial funding would be provided by the TDIC but derived from a flat fee contribution from all banks and finance firms. As a public policy induced bank, LCB would enjoy privileges from the BoT in the form of a rediscount and credit guarantee line on its debt issuing from BoT equal to its paid up capital for each line of credit. As a commercial specialized bank subjected to local and foreign competition, LCB would be charged premiums at market rates. The *risk adjusted premium* could be based on a variety of schemes such as those used in Taiwan, Canada and the United States. Alternatively, to prudently manage its own risk portfolio, the LCB could offer a block of the standard deposit insurer coverage policy for a monthly *open bid auction* - to 'comparable credit risk rating' member institution bidders.<sup>23</sup> These options would ensure that premiums and interest rate payments are sensitive to bank risk.

Peer Monitoring, DIS Legal Status and Management Incentives: The LCB, strictly speaking, would be a commercial bank without any DIS statutory rights for reimbursement. In the case of one insured bank failure, the LCB should have a legal priority claim expressed explicitly in the contract as a senior debt holder and it would act as the receiver of an ill-fated bank. LCB would determine the resolution, undertake the sale, recapitalization or liquidation and dispose of the remaining failed bank assets. All the insurance policy holders should have a priority claim as senior debt holders against the LCB. It should be noted that giving depositors a priority claim in an insolvency is not a complete solution as in a failure not all depositor claims will

<sup>23</sup>The right to bid could be given according to an ordinal ranking in bank performance with the quota to bid based on the ultimate price in tournament game sense paralleling that applied by Lazear and Rosen (1981), recent surveys by Burgess and Metcalf (1999) and discussed in a Thai context by Chaipravat and Hoontrakul (2001).

be met and even those that stand to recover their claims can face shortfall risk.

A key challenge with the LCB proposal will be its capacity to absorb the costs of a single large bank failure or the impact of systemic crisis. In such instances, we would suspect that the LCB would become a 'too-big-too-fail' problem for any government and would need to rely on emergency BoT lines of credit. Nonetheless, there are at least three strong incentives for LCB stakeholders to provide peer monitoring discipline and thus avoid the prospect of failures. First, because the LCB would be one of the main pillars of the banking system, all LCB equity holders would have strong incentives to support the viability of the LCB. Second, as previously mentioned, the surviving banks would have to pay ex post levies to the TDIC. Third, the 'club' nature of shared ownership from oligopolistic bankers is intended to mimic Germany's explicit peer monitoring and thus market discipline exercised by the members. Even in a weak regulatory environment, big banks have more to lose than to gain in letting small banks fail. This would be a different circumstance than in 1997 when big Thai banks initially benefited from 'depositor flight' from small finance companies and banks during the initial phase of the crisis.

In addition, sound management of the LCB could be provided by ensuring a strong market incentive environment. This could include the use of management contracts with objective covenants and various bond instruments linked to the risk profile of the LCB. The role of regulators in ensuring sound governance and management would be narrow in this regard but transparent and accountable.

**3.3.4 Trust Capital Building - the Role of Self-Policing Bank:** The government can set additional measures to contribute to the self-policing role for the banking community. Examples include the use of mandatory subordinated debt, extra capital and enhanced disclosure. This could be issued on a regular basis to provide information (through pricing) to the market and regulators, act as buffer to absorb any losses, and provide incentives for the debt holders to monitor the issuing bank. However, the market for sub-debt should be highly liquid and transparent to ensure that it functions efficiently and that market discipline is exerted by the holders of sub-debt. The maintenance of slightly higher than international BIS standards could also provide an extra cushion against financial stress and an effective signal to the financial community (see Chaipravat and

Hoontrakul (2001, p. 46)). Finally, key information on banks must be disseminated on a timely and regular basis with consistent accuracy to all stakeholders.

## Conclusions

Transitioning to a DIS should be seen as an integral component of a country's overall financial sector reform strategy and be recognized as fundamentally a dynamic, trust building, process-oriented management problem. In addition, a good transition process recognizes that both macro and micro issues must be dealt with sequentially. The macro economy must achieve a reasonable level of stability and its systemic issues must be addressed before moving on with micro structural reforms to support transitioning. In Thailand's case, the current macro environment, while far from robust, appears supportable of micro reform initiatives. And while the Thai financial sector remains fragile and improvement slow, supervisory, regulatory, legal and accounting reforms and restructuring are well underway and supportive of the eventual removal of blanket guarantees and introduction of a limited DIS during the next 2 to 4 years.

It is critical also when designing a DIS to effectively balance the dual conflicting goals of (1) protecting less-financially sophisticated depositors and contributing to financial stability and (2) minimizing bank incentives to take excessive risk. After taking into account Thailand's unique banking system structure - highly concentrated in both banks and large depositors - an innovative two-tier hybrid DIS model could address these challenges. A compulsory publicly administered and privately funded system to provide protection for *low* coverage deposits (i.e. similar to an FDIC, CDIC approach) in member deposit-taking institutions and a private/public partnership system - akin to that used by private banks in Germany - to provide additional protection for *high* coverage deposits.

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Table 1: Key Events in the Thai Financial Crisis<sup>24</sup>

3 March 1997	First official announcement of problems in 2 finance companies.
March - June	Bank of Thailand secretly gives liquidity support to 66 finance companies. Heavy capital outflows.
29 June	16 finance companies ordered to suspend operations. Guarantee issued to protect depositors' and creditors' funds in all remaining finance companies.
2 July	Baht floated; depreciates by 20%.
5 August	42 additional finance companies ordered to suspend operations. New measures adopted to strengthen financial sector.
20 August	IMF Stand-by agreement concluded, covering 3 years.
14 October	Comprehensive financial restructuring measures announced. Financial Restructuring Agency (FRA) established, asset management company created. New powers given to intervene in banks. Blanket guarantee strengthened.
24 October	Emergency decrees announced to help speed financial sector restructuring
November	Government changes.
8 December	58 suspended finance companies ordered permanently closed.
31 December	Bank of Thailand intervenes in one commercial bank.
23 January 1998	Bank of Thailand intervenes in two additional commercial banks.
11 March	Commercial bank purchased by foreign bank
31 March	Bank of Thailand establishes new loan classification and loan loss provision rules
18 May	Bank of Thailand intervenes in 7 finance companies
14 August	Financial restructuring measures introduced: public support for bank recapitalization. Bank of Thailand intervenes in 2 banks and 5 finance companies.
July 1999	One small intervened bank offered for sale. One commercial bank creates asset management company.

<sup>24</sup> Adapted from Lindgren et al. (1999), p. 4.

Table 2: Major Economic Indicators for Thailand: 1998 to 2001

Items	Unit	2000-P							2001-F		
		1998	1999	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3
GDP(Current prices)	Bil.Baht	4,628	4,615	1,218	1,186	1,210	1,276	4,891	1,232	1,262	1,247
GDP (1988 prices)	Bil. Baht	2,743	2,859	756	721	729	776	2,982	775	754	735
GDP Growth Rate(1988 prices)	%yoy	-10.8	4.2	5.2	6.2	2.8	3.1	4.3	2.5	4.6	0.8
Avg. Wage Rate	Baht/Day	162	162	162	162	162	162	162	162	162	0.8
Per capita GDP	Baht	75,660	74,708	19,592	19,032	19,365	20,383	78,374	19,608	20,045	19,767
	US\$	1,830	1,974	520	492	472	470	1,952	453	441	434
GNP (1988 prices)	Bil. Baht	2,671	2,802	754	716	727	777	2,974	763	747	730
GNP Growth Rate(1988 prices)	%yoy	-11.3	4.9	8.4	7.8	4.5	4.0	6.1	1.2	4.4	0.4
Consumption (1988 prices)	%yoy	-9.5	3.5	6.4	6.0	4.6	2.5	4.8	1.1	3.6	0.1
- Private Sector	%yoy	-11.5	4.0	5.2	5.0	4.1	3.9	4.5	0.4	2.8	0.9
- Public Sector	%yoy	3.6	0.9	14.3	12.0	7.1	-5.3	6.5	5.8	8.3	-3.5
Investment (1988 prices)	%yoy	-45.1	-4.0	28.2	2.4	-2.2	-2.0	5.7	-4.6	1.5	5.0
- Private Sector	%yoy	-53.2	-5.0	22.5	14.6	14.2	6.9	14.2	0.0	-3.0	-3.0
- Public Sector	%yoy	-29.4	-2.8	36.3	-14.6	-16.5	-15.5	-5.0	-10.5	9.9	14.5
International Trade											
-Merchandise Exports	Bil. US\$	52.9	56.8	16.2	15.7	18.0	18.0	67.9	16.0	15.9	17.2
% Change	%yoy	-6.8	7.4	27.8	15.0	22.5	14.4	19.6	-1.3	1.0	-4.7
-Merchandise Imports	Bil. US\$	40.6	47.5	14.3	14.8	16.5	16.8	62.4	16.0	15.4	16.3
% Change	%yoy	-33.8	16.9	42.7	28.0	33.8	23.6	31.3	11.6	4.2	-1.4
-Trade Balance	Bil. US\$	12.2	9.3	1.9	0.9	1.5	1.2	5.5	0.1	0.5	0.9
-Current Account	Bil. US\$	14.3	12.5	3.2	1.6	2.2	2.2	9.2	1.1	1.7	1.9
as% of GDP	%	12.8	10.2	10.0	5.1	7.5	7.4	7.6	3.8	5.9	6.9
Capital Account	Bil. US\$	-10.1	-8.0	-5.0	-2.8	-1.0	-1.7	-9.6	-0.8	-1.2	-1.5
Balance of Payments	Bil. US\$	1.7	4.6	-2.2	-0.4	0.4	0.2	-2.0	0.3	0.4	0.4
Total External Debt	Bil. US\$	105.1	95.6	92.0	87.7	84.0	80.3	80.3	78.7	77.0	75.2
- Public Sector	Bil. US\$	19.9	23.2	23.5	22.7	22.7	21.8	21.8	21.7	21.7	21.6
- Private Sector	Bil. US\$	74.0	59.6	55.8	52.4	48.9	46.4	46.4	44.5	43.3	42.2
- Monetary Authorities	Bil. US\$	11.2	12.8	12.7	12.6	12.4	12.0	12.0	12.4	12.0	11.3
International Reserves	Bil. US\$	29.5	34.8	32.3	32.1	32.3	32.8	32.8	33.0	33.5	33.9

Table 2: Major Economic Indicators for Thailand: 1998 to 2001 (Cont.)

Headline Inflation Rate	%yoy	8.1	0.3	0.8	1.6	2.2	1.8	1.6	1.4	1.6	1.7
Core Inflation Rate	%yoy	7.2	1.8	0.2	1.0	0.9	0.9	0.8	0.9	1.1	1.5
Cash Deficit(-) or Surplus (+)	Bil. Baht	-129.3	-154.4	-18.9	-12.7	-23.7	-52.7	-108.0	-32.5	-9.0	-28.6
Crude Oil Price (Brent)	\$/Barrel	12.8	17.9	26.9	26.7	30.6	30.0	28.6	26.3	26.6	27.5
Exchange Rate	Baht/us\$	41.35	37.85	37.65	38.66	40.99	43.34	40.16	43.25	45.50	45.50
N. Effective Exchange Rate Index of Baht	%ch.	-24.7	8.9	3.0	-2.6	-5.8	-5.5	-5.8	0.5		
R. Effective Exchange Rate Index of Baht	%ch.	n.a.	100.0	94.6	99.3	99.3	98.7	98.0	105.1		
<b>Financial Side</b>											
14-day R/P Rate(end of period)	%	12.13	1.91	1.64	1.50	1.50	1.50	1.54	1.50	2.50	1.50
Commercial Bank Deposits	Bil. Baht	4,595.9	4,575.0	4,611.2	4,641.3	4,735.0	4,816.0	4,816.0	4,883.3	4,966.2	4,971.5
Baht Loans*	Bil. Baht	5,163.9	5,301.7	5,260.2	5,245.0	5,470.3	5,524.6	5,524.6	5,489.1	5,496.7	5,470.6
<b>Production Side</b>											
Agriculture	%	-3.2	2.7	-3.0	4.6	3.7	4.2	2.2	4.0	0.1	0.5
Non-Agriculture	%	-11.6	4.4	6.2	6.4	2.8	2.9	4.5	2.9	3.0	4.7
Industry	%	-13.3	9.5	8.4	7.9	2.2	2.3	5.1	2.2	2.4	5.0
Services	%	-10.0	-0.1	4.2	5.0	3.4	3.5	4.0	3.6	3.6	4.4
<b>External Environment**</b>											
World Real GDP Growth	%yoy	0.8	3.7	6.5	5.4	4.6	4.0	5.5	2.1	2.1	2.1
World CPI	%yoy	3.0	1.2	1.0	1.1	1.6	1.9	1.6	2.2	2.2	2.2
Avg. of Non-Pegged Currencies/\$US	%yoy	n.a.	n.a.	-0.6	-0.9	3.6	9.8	2.7	9.1	11.3	

Note: *Italics are forecasts* \* including write offs and transfers to AMC+BIBF (exchange rate=Baht25.97 per US\$) \*\* AVG of 12 countries (CHN, HK, IND, MAL, PHP, SIN, KOR, TWN, THA, JPN, Euro Areas and US) weighted by their shares in Thailand's export markets.

Source : SCB Research Institute, Thailand [May 2001]

Table 3: Thailand's Financial System Structure: 1996 - 1999<sup>25</sup>

Type of Financial Institution	Before Crisis (1996)		After Crisis (July 1999)	
	Number	Share of Assets	Number	Share of Assets
Private domestic commercial banks	14	59%	7	39%
Private finance companies	90	20%	22	5%
Majority state-owned commercial bank	1	8%	0	0%
State-controlled commercial banks	0	0	6	28%
State-owned specialized banks	7	7%	7	15%
Branches of foreign banks	14	6%	14	12%
Public finance company	1	0%	1	1%
Total	127	100%	57	100%

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<sup>25</sup> Lindgren et al. (1988), Appendix 5, p. 101

**Table 4: Selected Indicators of the Thai Banking System** <sup>26</sup>

(Thai and Foreign Banks; billion baht)	1995	1996	1997	1998	1999	2000
Total Assets	4,86	5,536	7,43	6,41	6,190	6,26
Total Liabilities	4,30	4,849	6,34	5,57	5,501	5,69
Deposit Liabilities	3,42	3,876	4,26	4,57	4,608	4,86
Total Loan Portfolio	3,88	4,478	5,68	4,58	4,178	3,72
NPLs as a % of total loans	n/a	n/a	n/a	42.9	38.57	17.7
Provisions for loan losses (% of total loans)	0.4%	0.9%	3.5%	7.1%	7.3%	3.3%
Capital adequacy ratios						
Return on Equity	14.0%	8.5%	-6.6%	-42.5%	-105.6%	0.1%
Return on Assets	1.6%	1.1%	-1.0%	-5.5%	-6.2%	0.0%

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<sup>26</sup> Lindgren et al. (1988), Appendix 5, p. 101

Table 5: Outstanding Non-performing Loans in Thailand, Classified by the Financial Institutions Group

Units: Billion Baht	1998			1999				2000				2001 (est)
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
<b>Private Banks</b>	994.2	1,165.5	1,239.9	1,293.8	1,222.	1,124.1	885.4	841.7	570.	528.3	476.4	481.4
(% to total loans)	30.2	36.9	40.5	42.3	41.	38.1	30.6	29.3	21.	20.2	18.0	18.1
<b>State-owned Banks</b>	786.0	920.5	1,036.7	1,160.1	1,175.	1,174.7	1,057.3	1,012.7	943.	494.5	308.1	304.8
(% to total loans)	47.2	55.1	62.4	68.4	70.	66.9	62.8	60.7	56.	33.2	21.6	21.2
<b>Foreign Banks (full branch)</b>	52.3	63.1	74.2	85.5	86.	81.8	61.6	56.5	43.	39.3	38.2	28.6
(% to total loans)	0.0	7.5	9.8	11.5	12.	11.5	9.9	9.0	7.	6.3	6.6	4.9
<b>Total Commercial Banks</b>	1,832.5	2,149.2	2,350.8	2,539.3	2,484.	2,380.6	2,004.3	1,910.9	1,556.	1,062.1	822.6	814.8
(% to total loans)	31.0	37.9	42.9	46.2	46.	44.0	38.6	37.0	31.	22.4	17.7	17.4
<b>Finance Companies</b>	257.8	289.0	323.7	170.6	168.	150.1	90.1	86.0	60.	57.2	34.8	32.4
(% to total loans)	52.6	60.4	70.2	65.5	67.	62.3	49.2	47.9	38.	35.7	24.5	22.6
<b>Grand Total</b>	2,090.3	2,438.1	2,674.5	2,710.0	2,652.	2,530.8	2,094.4	1,996.9	1,617.	1,119.3	857.3	847.2
(% to total loans)	32.7	39.7	45.0	47.1	47.	44.8	38.9	37.4	32.	22.9	17.9	17.6

**Table 6: Eleven Structural Reform Laws** <sup>27</sup>

	Function	Purpose of the Act	Status
1. The Establishment of Bankruptcy Court Act	<ul style="list-style-type: none"> <li>- To set up the Bankruptcy court as a specialized court with a specialized legal procedure.</li> <li>To introduce Specialized Judges for bankruptcy court.</li> </ul>	<ul style="list-style-type: none"> <li>- To bring about more timely legal proceedings and verdicts for bankruptcy cases.</li> <li>- To reduce the accumulated loss incurred between two parties by reducing the time taken for hearing.</li> </ul>	Enacted since 8 <sup>th</sup> April 1999
2. The Amendment to the Bankruptcy Act.	<ul style="list-style-type: none"> <li>- To permit an individual person to be filed for indebtedness from debt valued at 1,000,000 baht instead of 50,000 baht.</li> <li>To let a business entity to be filed for indebtedness from debt valued at 2,000,000 baht instead of 500,000 baht.</li> <li>- To permit creditors to claim for debt repayment if such debts are for rehabilitating an insolvent debtor's business.</li> <li>- To allow debtors to retain fixed assets valued up to 100,000 baht instead of 3,000 baht</li> <li>To introduce new creditor classifications and groupings for the purpose of approving rehabilitation plans.</li> <li>To reduce Bankruptcy status from 10 to 3 years.</li> </ul>	<ul style="list-style-type: none"> <li>- To adjust the value of indebtedness in line with developments in the economy</li> <li>- To encourage debt restructuring process of insolvent businesses.</li> <li>- To allow debtors to have more of the remaining fixed assets to sustain themselves during the liquidation period.</li> <li>- To eliminate the absolute power of certain creditors and debtors over the majority and facilitate the approval and adoption of rehabilitation plans.</li> <li>- To lessen the impact of economic hardship for persons in liquidation status.</li> </ul>	Enacted since 21 <sup>st</sup> April 1999
*3. Amendment to the Civil Procedure Code On Petty case	To clarify legal proceedings of petty cases to accommodate petty charges of indebtedness with emphasis on rapid resolution.	- To simplify court procedures for petty cases.	Enacted since 3 <sup>rd</sup> May 1999
*4. Amendment to the Civil Procedure Code On Execution of Judgment	- To limit the court's discretionary power on rescinding auction sale to 2 reasons: (1) fraud among the bidders; and	<ul style="list-style-type: none"> <li>- To eliminate false claims of under priced assets in attempt to prolong the sale and debt repayment process.</li> <li>- To avoid unnecessary delays</li> </ul>	Enacted since 3 <sup>rd</sup> May 1999

<sup>27</sup> Table taken from the website for the Ministry of Finance: <http://www.mof.go.th>.

Table 6: Eleven Structural Reform Laws (Cont.)

	Function	Purpose of the Act	Status
	(2) officers' malfeasance - Certain court orders can no longer ask for appeal.	in court execution.	
*5 Amendment to the Civil Procedure Code on Default Judgment	- To limit the right of defendants to ask for reconsideration when a defendant is in default of appearance willfully or without appropriate reason.	- To penalize the absent party	Currently in the senate reading before Parliament.
6. The Corporatization Bill	- To convert State enterprises into corporations. State ownership will be converted into shares. - To establish a corporatization committee to oversee the conversion process.	To facilitate the privatization process. - To allow state enterprises raise capital directly from the capital market without adding burden to the government. To promote greater management efficiency and transparency.	Currently before the Constitutional Court.
7. The Alien Business Bill	- To require foreign investors who ask for permission to conduct business in Thailand to bring in capital. The amount of capital depends upon the type of business. - To allow greater liberalization in the job categories allowed for foreigners.	- To promote capital inflows from foreign investors and greater liberalization	Currently in the reading before Parliament.
8. The Act on Leasing of Property for Commerce and Industry	- To extend the leasing period from 30 years to 50 years, renewable for another 50 years - To define the leasing rights as an asset rights which can be transferred from one party to another.	- To attract long-term commercial and industrial investors that require large capital investments and have a long breakeven period. - To facilitate long-term investment.	Enacted since 18 <sup>th</sup> May 1999
9. The Amendment to the Land Code	To allow foreign investors who bring in the	- To accommodate foreign investors who undertake	

**Table 6: Eleven Structural Reform Laws (Cont.)**

	Function	Purpose of the Act	Status
	capital at least 40 million baht to own 1 rai (0.25 acres) of land for their residence.	business in Thailand.	
10. The Amendment to the Condominium Act	<ul style="list-style-type: none"> <li>- To allow foreigners to own more than 49% of the space of condominiums in Bangkok, municipal areas, or local administration as specified by regulations if the total space of the condominium is below 5 rais (1.25 acres).</li> <li>- To allow foreigners to own not more than 49% of condominium outside the above areas.</li> </ul>	- To attract foreign investment in ailing real – estate sector.	Enacted since 27 <sup>th</sup> April 1999
11. Social Security Law	- To extend the compensation period from 6 to 12 months for the unemployed who are insured under the law.	- To help alleviate those made redundant during crisis.	Enacted since 31 <sup>st</sup> March 1999

Table 7: Deposits Classified by Sizes

Period	No. of banks	< 100,000 baht		100,000-200,000 baht		200,000-500,000 baht		500,000-1,000,000 baht		1-10 million baht		> 10 million baht		Total	
		No. of Account	Million baht	No. of Account	Million baht	No. of Account	Million baht	No. of Account	Million baht	No. of Account	Million baht	No. of Account	Million baht	No. of Account	Million baht
Dec.1989	30	26,522,392	159,324.2	638,856	85,787.2	425,252	127,128.8	172,34	120,972.0	164,905	371,130.4	7,629	262,842.3	27,931,381	1,127,184.9
Dec.1990	30	28,263,959	184,752.6	717,535	100,382.3	503,837	159,064.9	220,71	163,950.2	202,555	490,634.7	10,094	333,950.6	29,918,690	1,432,735.3
Dec.1991	30	29,534,858	202,676.9	786,044	108,715.4	559,171	174,387.6	241,11	176,385.0	243,774	592,433.7	13,621	485,542.4	31,378,578	1,740,141.0
Dec.1992	30	32,929,459	228,856.0	874,990	120,904.4	621,332	195,072.6	264,99	194,082.3	291,801	689,731.4	16,968	595,450.4	34,999,545	2,024,097.1
Dec.1993	29	33,255,289	243,786.5	962,578	132,460.9	686,465	215,106.8	290,71	211,801.1	318,450	809,676.7	22,108	800,432.4	35,535,604	2,413,264.4
Dec.1994	29	36,757,740	271,024.5	1,089,037	149,625.7	781,623	241,328.5	329,30	237,372.4	363,494	891,380.3	25,244	922,544.0	39,346,445	2,713,275.4
Dec.1995	29	38,879,114	304,651.4	1,235,726	170,683.0	884,022	276,544.5	375,82	272,623.6	421,334	1,076,795	30,902	1,059,928.7	41,826,924	3,161,226.3
Dec.1996	29	42,820,609	333,732.2	1,355,185	185,263.5	978,563	303,073.9	418,20	301,791.5	467,391	1,298,984	38,578	1,188,383.9	46,078,528	3,611,229.6
Dec.1997	35	45,938,586	327,477.0	1,387,044	193,339.0	1,011,317	314,840.1	461,22	329,147.0	542,976	1,385,846	58,796	1,679,320.6	49,399,939	4,229,970.0

Source :  
C.B.8

**Table 8: Summary Checklist of Trigger Points**

	Current Situation	Trigger Point	Ideal Situation
<b>Macroeconomic</b>			
- economic growth	sustained growth,	sustained growth, 2.5 to 5 %	at potential
- balance of payments	improving	Stable	improving
- inflation	low	Lower than World CPI	low
- interest rates	declining	stable	similar to US\$ rates
- exchange rates	volatile	stable	Stable
<b>Stability of banking system</b>			
- contain systemic risk	yes	yes	yes
- restore confidence	low, but improving	restored for most stakeholders	confirmed by market survey
- capital adequacy restored	no	sustainable, improving trend	yes
- assets (quality improving, credit risk management practices tightened)	no	sustainable, improving	pre-crisis levels
- NPLs declining	yes	sustainable, improving	pre-crisis levels
- credit growth	yes	sustainable, improving	pre-crisis levels
- liquidity	yes	sustainable, improving	pre-crisis levels
- management soundness	yes	sustainable, improving	pre-crisis levels
- earnings and profitability (uptrend?)	yes	sustainable, improving	pre-crisis levels
- market risk	yes	Sustainable, improving	pre-crisis levels
<b>Legal Reforms</b>			

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Table 8: Summary Checklist of Trigger Points (Cont.)

- reform/improvement of existing laws	initiated	nearing completion	complete
(bankruptcy and closure, governance)	initiated	nearing completion	complete
- progress on enactment of any new required laws	initiated	nearing completion	complete
- progress on enactment of specific DIS law	initiated	nearing completion	complete
<b>Prudential Regulation and Supervision</b>			
- meet with international codes	no	well underway	fully compliant
- progress in enhancing examination processes	initiated	well underway	fully compliant
- progress in meeting BASIC requirements	initiated	well underway	fully compliant
<b>Accounting and market disclosure system</b>			
-meets international codes for accounting and transparency	partial compliance	partial compliance	full compliance
<b>Public awareness</b>			
- receptiveness of public to transitioning	low	Moderate for small and large depositors	fully receptive
- progress on public awareness campaigns	Urgently need to be initiated	Moderately con-firmed by survey	Complete

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