

***Fourth Round Table on Capital Market Reform in Asia
09-10 April 2002, Tokyo***

Room Document 23

Country Note of Thailand

By Mr. Prasarn Trairatvorakul

***ORGANISATION FOR ECONOMIC CO-OPERATION AND
DEVELOPMENT***

Asian Development Bank Institute

Country Note

Development of the Thai Capital Market

Prasarn Trairatvorakul
Secretary-General
Securities and Exchange Commission
Thailand

Fourth Round Table on Capital Market Reform in Asia
9-10 April 2002
Tokyo, Japan

This country note is prepared with an aim to provide latest information on development of the Thai capital market in the requested areas as follows: market structure, regulatory structure, corporate governance, and issuers. We hope that this paper can give a better view on what really happened in the Thai capital market and what we could expect from the future.

Market structure

• Demutualisation

In order to cope with advanced technology and increased competition, we have realized that the Stock Exchange of Thailand (SET) is necessary to transform to a profit-oriented company like many exchanges in other countries. When we start to explore this issue in more detail, we have found that the SET's governance structure is not in the form of mutual organization which is wholly funded and operated by the members. In fact, the government also helps provide a support to the operations of the SET by (i) granting monopoly status, (ii) giving tax privilege for investors trading on exchange, and (iii) giving corporate tax exemption. Presently, half of the SET's board of directors has been appointed by the Securities and Exchange Commission (SEC) and the remains have been appointed by the members. The SET therefore has unclear ownership structure and could not be immediately demutualised. In the current proposal, there will be 4 steps heading towards the full demutualisation. Firstly, the SET's board of directors will be chosen in such a way as to represent the interest of a wider set of stakeholders. Secondly, the SET will be corporatized to become a for-profit organization. The newly corporatized company is aimed to operate more competitively with a market-driven mind and focus on serving best interest of the market. Thirdly, its shareholder base will be broadened to include other stakeholders. Lastly, there will be an initial public offering widely open for public investments. To achieve this goal, the SET has set up a steering committee to determine guidelines for corporatization, comprising

representatives from the organizations concerned including the SEC. In addition, the government has accepted this idea and already incorporated it into the capital market master plan.

- **Cross border alliances**

The SEC has realized that forming alliances with overseas exchanges can help support business development and enhance competitiveness. It is expected that the foreign partners can help expand the investor base, provide more liquidity to the market, and increase investment options for investors as well as funding options for listed companies. Currently, Thai investors are not allowed to invest freely in foreign securities markets due to the restrictions on capital flow. This measure is regarded as the main problem that makes an alliance become unattractive to the potential foreign partners. However, there are recently many initiatives on cross border alliance arising from foreign counterparts. For example, the government of Singapore has proposed that there should be cross listings between Thailand and Singapore stock exchanges. The New York Stock Exchange has also expressed an interest in having Thai stocks to be listed on its platform. Such initiatives are now under the consideration by related authorities. And the alliance issue has already been contained in the SET's long-term plan.

- **Mergers of securities and derivatives markets**

The financial derivatives market bill is now in the parliament. We do not know for certain how long it will take before the bill becomes effective. Presently, the SET seems to be the most likely organization from the private sector that will undertake the task of derivatives market development. Other groups either securities brokers, commercial banks, or asset management companies have not been seen stepping forward for such market development after the crisis. It is believed that, in order to get the width and depth of the market, the products in Thai derivatives market should be ones that cross traditional business lines of stock brokers and banking industries. Therefore, it can be expected that participants in the derivatives market will be those who operate in both securities and derivatives market though the form of the marketplace has

not been clear yet. Under the financial derivatives market bill, the SEC will also be the regulator of derivatives market.

Regulatory structure

- **Conglomerates**

This issue is not new to our financial system because Thai financial institutions have long been operated in a group with a commercial bank as the lead organization, with subsidiaries licensed to conduct business in other financial markets such as securities, leasing, and mutual funds. Some commercial banks are also affiliated with insurance companies. The important issue is that, as in other countries, the Thai financial markets are characterized by much overlapping of the products and services offered by different types of financial institutions. While this competitive diversity is probably beneficial to the investors, the overlapping of financial services and products presents the supervisors of individual market sectors with the challenge of harmonizing their respective regulatory regimes to assure that one type of institution does not enjoy unjustified advantages. To cope with this issue, close cooperation among different supervisory bodies is essential to ensure effective and consistent supervisory practices, which include streamlining related rules and regulations, ensuring group capital adequacy, assessing risk concentration, and monitoring intra-group transactions. In this respect, a working group, consisting of representatives from related authorities including the SEC, has been established to develop a regulatory framework to enable the development and ensure the effective supervision.

- **Governance of the regulators**

The draft of the amendment of the Securities and Exchange Act has already been submitted to the MOF for further consideration. The objective of the amendment is to ensure the SEC autonomy, delineate regulatory and supervisory authority, increase accountability of the SET, and improve the transparency and efficiency of its operations as well as to improve the effectiveness of the enforcement mechanism. The proposed structural change in the composition of the SEC Board of Commission by having a majority of commissioners appointed on a full-time basis including the Chairman, should enable the SEC to become a more market oriented supervisory agency, insulate it from outside interference and be better able

to adapt to the changing market environment. Moreover, by having inquiry officers and public prosecutors working full-time at the SEC should help speed up the prosecution process.

- **Integrated regulators**

We have found that most of regulatory structures in many countries, including that of Thailand, have been based on a traditional model that has separate regulators to supervise different financial institutions. However, banks are more active and play an important role in securities transactions. And many financial products of insurance companies have their intrinsic features like those of banks and securities companies. It is evident that the financial functions tend to become more important than the financial institutions. The current regulatory structure therefore has to be reconsidered to enhance market efficiency, ensure systemic stability, and provide investor protection. Up to now, we have observed that there are three models of regulatory structures currently adopted by foreign regulators which are (i) multiple regulators model based on financial institutions, (ii) multiple functional regulators model (like that of Australia), and (iii) single regulator model (like that of the UK). However, we have not thought it through enough to decide which one would be appropriate for the Thai financial system. But we strongly believe that the regulatory structure should follow the market structure. And we are still deciding on the market structure issue. Therefore, the current regulatory model will not be changed drastically. What we have recently proposed is to change the present structure of the SEC to be more flexible to the changing market environment and to enhance the coordination among different regulatory agencies. To improve on the coordination, the SEC has proposed setting up the financial market committee, comprising a number of representatives from the Ministry of Finance, the Bank of Thailand, the Department of Insurance, and the SEC, to facilitate the coordination among related authorities, conduct an information sharing, and jointly develop a regulatory framework.

Part III: Corporate governance

- **OECD Principles of Corporate Governance**

Regarding the OECD Principles as benchmarks, we have found that many measures taken to promote good governance of listed companies are developed accordingly. The SEC has issued regulations to ensure that shareholders' rights and interests are protected. For instance, issuing companies are required to have check and balance management structure in order to prevent conflict of interests and to act in the interests of minority shareholders. Besides, the veto right for minority shareholders in case of important issues is also imposed. The SEC has also supported the amendment to the Public Company Limited Act in order to elevate the roles and responsibilities of directors. This includes mechanism to prevent directors from making use of companies' opportunities for their own benefits. Moreover, the SEC has encouraged the formation of an investor association which will serve as an information center for investors and will monitor company's operations, advise members, and participate in shareholders' meeting. Apart from the aforementioned, the SEC strictly takes legal actions against non-compliance and wrongdoers. Thus, the directors of companies must operate their businesses more carefully in accordance with the specified rules and regulations.

- **Closely held companies listed on stock markets**

The SEC has supported mechanism that can help listed companies to successfully embrace the discipline of good governance practices. For example, the SEC will amend its rules and regulations concerning connected transaction so that they would be more firm and responsive. Moreover, any existing connected transaction practices will be inspected to ensure both the fairness in conducting businesses and the high professional standards. Besides the governance issue, the SET has revised its listing rules to cover that issuing companies must have individual share holdings in an aggregate not less than 20% of their paid-up capital. This requirement can help increase the free float of shares circulating in the market, thereby enhancing market liquidity. In the year 2002, the SEC has a plan to introduce governance rating among listed companies. The criteria for governance rating will be focused on the area of transparency, fairness, accountability, and responsibility of companies and directors.

- **Financial institutions**

Good corporate governance has become a major focus in Thailand, particularly within the realm of the Thai financial sector. The BOT has established a working group, with participation from the industry, to explore the structure of locally-incorporated banks and practices used by the international community in order to recommend the most suitable guidelines for the Thai financial sector on the practice of good governance. To ensure high ethical and operational standards in conducting securities businesses, major shareholders and management of securities companies are required to obtain an approval from the SEC. Securities companies must maintain sound operational standards, proper systems for internal control, and risk management system, including system that will serve to prevent conflict of interests. In addition, securities companies need to know their clients in order to provide appropriate services, disclose accurate information, and provide safe keeping clients' assets.

Part IV: Issuers

- **Debt restructuring initiatives**

To facilitate financial restructuring and rehabilitation of listed companies, many of which are problems of NPL within the financial system, the SEC has allowed public companies to issue convertible debentures with a term for a mandatory conversion. As a result, public limited companies can now issue convertible debentures that actually force the holders to convert into new shares. However, as this type of debentures has high risk, only private placement issue to institutional investors is allowed. Moreover, the private sector still needs instruments to facilitate their investment in property and loan to help the financial institutions. The SEC has therefore allowed the establishment of Property and Loan Fund. This fund is a special type of fund with the objective to recover the NPL problems of financial institutions as well as incomplete projects.

- **SMEs and Venture capital**

One of the government's measures to stimulate the economic recovery is to encourage private investments especially in small and medium-sized enterprises (SMEs). The SEC has realized that many SMEs who have potential for

growth need to be given support to raise fund through the capital market. In this regard, such companies must receive funding from institutional investors and assistance in term of management system, accounting standards, and internal control. The venture capital has therefore been developed to help support the newly established enterprises. To promote this business, venture capital companies will get tax exemption on dividend and capital gains received from investments in SMEs. The SEC is now responsible for regulating venture capital business to ensure that venture capital companies can allocate their funds to invest in SMEs efficiently according to the specified rules and regulations.