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*Informal Work Outs for Corporate Debt Restructuring in Thailand:
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Informal Work Outs for Corporate Debt Restructuring in Thailand

Mecchanism, Techniques & Challenges of Financial Crisis Management*

The economic crisis that erupted in 1997 resulted in numerous corporate failures and a record number of non-performing loans (NPLs) in the financial system. The highest level reached 47% of total credits in the system in 1999. The high level of non-performing loans was thus an inevitable consequence. Unfortunately, the resolution of the debts that had thus piled up is turning out to be very difficult and time-consuming, due to various factors including the internal infrastructures that were not designed to cope with such problems.

However, to address the NPL problems, the informal workout process has been founded and the formal process in the court has been amended. To support the informal workout process, Thailand has instituted the central bank guidelines for debt restructuring, Bangkok Framework, the Inter-Creditor Agreement, Debtor-Creditor Agreement, Court Mediation Center guidelines and other incentives. In addition, The government has also amended the Bankruptcy Law to allow the qualified debtors to restructure their bad debts through the court process.

Informal Workout Mechanisms

A number of informal workout mechanisms have been established to tackle the distressed asset problem after the severe economic crisis in 1997. They include the Central Bankruptcy Court, Financial Sector Restructuring Authority (FRA), Asset Management Corporations (AMC), State-owned Asset Management Companies, Privately-owned Asset Management Companies, Thailand Asset Management Corporation (TAMC), Corporate Debt Restructuring Advisory Committee (CDRAC), Provincial Sub-committee for Debt Restructuring, Court Mediation Center and SMEs & P Financial Advisory Center (SFAC).

The tools used for expediting the informal workouts include the Bank of Thailand's Notification on Debt Restructuring (or BOT's Guidelines), the Framework for Corporate Debt Restructuring in Thailand (Bangkok Framework), Inter-Creditor Agreement on Restructuring Plan Votes and Executive Decision Panel (ICA), Debtor-Creditor Agreement on Debt Restructuring Process (DCA) and the Simplified Debtor-Creditor Agreement (Simplified Agreement or SA)

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Techniques Used in the Informal Workout to Facilitate Debt Restructuring

1. BOT's Guidelines for Debt Restructuring

To facilitate informal workouts, in 2 June 1998, the Bank of Thailand (BOT) issued a notification to serve as a general guideline for financial institutions in order to assist in the restructuring of the large number of distressed assets in the financial system. The guidelines were later amended on 1 June 1999 to reflect the practical issues. If the debt restructuring of any cases followed these guidelines, the cases will qualify for the pre-arranged tax benefits and duty-stamp exemptions and reduction of land transfer fees to 0.01%. The key elements of the guideline are as follows:

1. Debt restructuring should be carried out to maximize the creditor's chances of getting repayment subject to the debtor's ability to repay the loan, or in some other way improve on the conditions set out in the original contract to both parties. In particular, debt restructuring should be carried out to help debtors who have difficulties in loan repayment due to the effects of an economic crisis but are expected to recover in future. Financial institutions should ensure that restructuring is not carried out with the objective of postponing or avoiding debt classification or provisioning requirements, or the avoidance of stopping interest accruals.

2. Financial institutions must establish a formal strategy for debt restructuring whereby the highest level of management should participate directly in formulating this strategy. The strategy must form part of the institution's written business policy. In addition, the strategy should cover every stage of the restructuring process from start to finish including clear time-bound objectives, the approach and methodology for evaluating and granting loans, measures for monitoring and reporting on performance against those objectives to ensure that the restructuring has been carried out correctly in terms of its objectives and its accounting principles.

3. From the onset, financial institutions must clearly set out written procedures regarding the role and responsibility of officials in restructuring approval, reporting, and monitoring of the restructuring case, including the formation of an action plan for every stage of the restructuring process.

4. In cases where the financial institution is affiliated with or has interests in the debtor due to its involvement in assisting the debtor to solve its troubled debt difficulties, institutions are not required to use another financial institution or third party to evaluate the debtor's financial status, the debtor's repayment capacity, or his cash flows.

5. Financial institutions must draw up action plans and prepare the relevant documents in each stage of the debt restructuring.

6. Financial institutions must have follow-up procedures to monitor restructured loans which are in accordance with the regulations set out. This is to ascertain whether debtors are able to repay their debts as agreed in their revised contracts.

As these BOT guidelines are only general approaches for regulatory purposes, each individual financial institution must develop their own specific procedures of operation that is not only in line with the BOT guidelines, but also most compatible with its institutional structure and seek approval from the Bank of Thailand.

2. Bangkok Framework

In order to generate a more coordinated informal workout approach, the Board of Trade of Thailand, Federation of Thai Industries, the Thai Bankers' Association, the Association of Finance Companies and the Foreign Banks' Association jointly prepared a Framework for Corporate Debt Restructuring in Thailand in early 1998. The framework is non-binding and non-statutory but is a statement of the approach that is expected to be adopted in corporate workouts involving multiple creditors. The framework exists based on general market acceptance and its practices may be altered or amended to serve the needs of the business and financial communities.

The basic premise is to ensure that a business can survive if there is a reasonable possibility that it is viable. The framework is designed to promote a spirit of timely co-operation amongst concerned stakeholders for their mutual benefits. There was no intention within this approach to force any creditor to forgo any rights.

The objective was the successful implementation of an informal framework outside court proceedings for the efficient restructuring of the corporate debt of viable entities to benefit creditors, debtors, employees, shareholders and the Thai economy. This would be done by minimizing losses to all parties through coordinated workouts and also prevent companies from being placed unnecessarily into liquidation, thereby preserving jobs and productive capacity wherever feasible. There are 19 Principles included in the Framework that are complimentary to the Bank of Thailand Guidelines. Some key Principles of the approach are as follows:

1. Any corporate debt restructuring should achieve a business, rather than just a financial, restructuring to further the long term viability of the debtor.

2. Priority must be given to rehabilitate assets to performing status in full compliance with Bank of Thailand regulations. For example, financial restructuring must not be implemented in a manner to merely avoid debt classification or the maintenance of reserves or to evade income recognition rules.

3. Each stage of the corporate debt restructuring process must occur in a timely manner.

4. Both creditors and debtors must recognize the absolute necessity of active senior management involvement throughout the duration of the debt restructuring process.

5. New credit extended during the debt restructuring process above existing exposures as of the standstill date on reasonable terms in order that the debtor may continue operations must receive priority status based on tile oriented security, inter-creditor agreements or indemniti.

3. CDRAC's Debt Restructuring Process

The Joint Public-Private Consultative Committee (JPPCC) Resolution dated 22 June 1998 established the Corporate Debt Restructuring Advisory Committee (CDRAC) to encourage and accelerate informal workouts. CDRAC's key role is to act as a facilitator or an independent intermediary in the restructuring process in order to facilitate and expedite the negotiation among all parties concerned. The Governor of the Bank of Thailand is the

Chairman of CDRAC, while its members are represented by the chairpersons from both the creditor and debtor associations, namely the Thai Bankers' Association (TBA), the Foreign Banks' Association (FBA), the Association of Finance Companies (AFC), the Federation of Thai Industries and the Board of Trade of Thailand. The Bank of Thailand provides a Corporate Debt Restructuring Group (CDG), formerly known as the Office of the Corporate Debt Restructuring Advisory Committee, as the secretariat to coordinate and facilitate the debt restructuring between parties concerned and operate in accordance with the resolutions of CDRAC and the Director of CDG is also a CDRAC member and secretariat.

CDRAC's restructuring process is based on the Inter-Creditor Agreement on Restructure Plan Votes and Executive Decision Panel Procedures (ICA), the Debtor-Creditor Agreement on Debt Restructuring Process (DCA) that are used for large and multi-creditor debtors and the Simplified Agreement (SA) that is used for small- and medium-sized debtors. These Agreements were modified from the Bangkok Framework, approved by CDRAC and signed by financial institutions in Thailand in March 1999 as part of the operation of the structured informal work-out process through the CDRAC.¹

The ICA provides the basic conditions under which the creditor parties to a work-out will conduct themselves in endeavoring to reach consensus on proposed plans for corporate restructuring. It deals with such things as voting on plans, time limits for decisions, mediation of inter-creditor disputes, and the appointment of an 'executive decision panel' to review and approve or reject a proposed plan. The decision of the executive panel is final and binding on the creditors who have executed the inter-creditor agreement

The DCA is required to be signed into the Agreements by a debtor corporation that seeks to invoke the CDRAC informal work-out process. The debtor must be first approved as a target debtor by the CDRAC. In essence, this Agreement is made with the banks and other financial institutions that have agreed to the Inter-Creditor Agreement. The DCA binds the parties to the Inter-Creditor Agreement. The DCA provides for such things as convening of meetings, lead creditor, steering committee, provision of information, promises by the debtor while the negotiation process is under way, mediation of disputes, debt trading, voting and approval of plan, implementation of plan. The agreement contains detailed schedules for the commencement and advancement of the workout process and of information that the debtor is required to provide.

The negotiation of debt restructuring is processed under the tight schedule made by the DCA. If the negotiation is carried according to the schedule and can be settled by the First Vote, it would take only between 4 and 5 months. The conditions for a Sufficient Plan Approval is that not less than 50% of the creditors *and* not less than 75% of the credits outstanding of voting creditors vote in favor of the plan. If the plan is not approved in the First Vote, the debtor has the opportunity to amend the plan in accordance with the comments of the disapproving creditors and re-submission for a second vote.

If, in the second vote of the creditors under step 11 of the Process Schedule, a Proposed Plan is approved by creditors holding not less than fifty percent (50%) of the total Credits owed to voting creditors or not less than fifty percent (50%) of the number of voting creditors, but does not receive Sufficient Plan Approval, the Steering Committee, Lead Institution or any Creditor shall submit the Proposed Plan to CDRAC within ten Business Days from the date of such second vote with a request for CDRAC to appoint an Executive Decision Panel.

For the sole purpose of a binding decision on the approval or rejection of a Proposed Plan, the Creditors under this Agreement may establish an independent executive decision panel (the "Executive Decision Panel") consisting of three executives appointed from three separate lists of executives proposed by each of the TBA, the FBA and the AFC, approved

¹ Initially, these agreements were signed by commercial banks, finance companies, EXIM Bank, and the Industrial Finance Corporation of Thailand. In 2001 and 2002, asset management companies also signed into these agreements.

by all three such Associations and submitted to CDRAC . If the Creditors under this Agreement in respect of the relevant Debtor consist of financial institutions which are members of each of the three Associations, the members of the Executive Decision Panel will consist of one executive appointed from each of the three lists of executives, unless an Association(s) elects to give up the right to appoint an executive to one of the other Association(s), which executive shall then be appointed from the list of such other Association(s). If the Creditors under this Agreement of the relevant Debtor consist of only financial institutions which are members of two of the three Associations, the members of the Executive Decision Panel will consist of one executive appointed from each of the lists of the two Associations whose members are Creditors under this Agreement and the two such appointed executives shall mutually select one additional executive from the list of the two involved Associations.

Executives shall be appointed by CDRAC in rotation (subject to executive availability and acceptance and the absence of any conflict of interest in the order their names appear on the lists of executives proposed by the TBA, FBA and AFC.) No executive on an Executive Decision Panel shall be a shareholder, director, officer, or employee of any Debtor, Affiliate of the Debtor or any Creditor under this Agreement having outstanding Credit to the Debtor or any other person who has an association with the Debtor which may give rise to a conflict of interest. Each of the TBA, FBA and AFC shall ensure that its appointees have adequate experience in both finance and debt restructuring. The Executive Decision Panel may appoint one or more financial advisors, lawyers and other experts, at the expense of the Debtor (to be taken into account in any Approved Restructuring Plan), to advise or work for the Executive Decision Panel on such matters as the Executive Decision Panel may deem necessary.

In the event of any submission of a Proposed Plan to CDRAC, this Agreement will continue to be binding on all Creditors under this Agreement, provided however, that any Creditor under this Agreement may elect in writing not to continue to be bound to this Agreement for its particular Credit (regardless of amount) to a Debtor that has Credits outstanding totaling in aggregate more than Baht 1,000,000,000 (one thousand million Baht) in principal obligations. To be an effective election, such Creditor under this Agreement must provide notice of such election to CDRAC and the Lead Institution or Steering Committee within ten Business Days of service of the Statement of Issues under section 6(b) of the ICA². Such notice must state specific reasons for the election and the minimal amendments to the Proposed Plan necessary to cause the Creditor under this Agreement to be bound hereunder as regards the Proposed Plan. CDRAC shall provide any such notices to all Creditors under this Agreement within three Business Days of receipt thereof.

If, after completion of the second vote of the Process Schedule, the Proposed Plan is not approved by creditors holding at least fifty percent (50%) of the total Credits of all voting creditors or being at least fifty percent (50%) of the number of voting creditors, the Creditors under this Agreement shall immediately file a joint petition with a court having jurisdiction for collection of all their Credits and/or the reorganization under new management or the liquidation of the Debtor.

² 6(b) When a Statement of Issues is filed with CDRAC, within three Business Days CDRAC shall deliver to all Creditors under this Agreement with the Statement of Issues at their respective domiciles or places of business by telefax, return post or by any other means as it deems appropriate

Enforcement Mechanisms

All stakeholders commit to a definitive timetable for restructuring, forcing decisions to be made and actions to be taken and the process includes guidelines for all parties to follow, making the restructuring clear and concise. The structured informal process has been significantly assisted by the ICA and DCA through the efficiency enhancement of and the avoidance of unnecessary delays in the process. These Agreements provide for mechanisms to deal with any breaches of the agreements.

The occurrence of any of the following events shall constitute a breach of this Agreement :

- a. the Debtor for any reason fails to perform or observe any of its obligations under this Agreement and, if such failure is capable of remedy, the Debtor does not effect a full remedy within five Business Days;
- b. any representation or warranty given, made or deemed made by the Debtor is or becomes or proves to have been untrue, incorrect or misleading in any material respect and, if capable of remedy, the Debtor does not effect a full remedy within five Business Days;
- c. this Agreement or any part hereof shall at any time for any reason cease to be in full force and effect or shall be declared to be void or shall be repudiated or frustrated or the validity or enforceability hereof shall at any time be contested by the Debtor or any person, or the Debtor shall deny that it has any or further liability or obligations hereunder;
- d. any action or proceeding of or before any court or authority shall be commenced to enjoin or restrain the performance of and compliance with the obligations expressed to be assumed by the Debtor hereunder, or in any manner to question the legality, validity, binding effect or enforceability of this Agreement;
- e. Any governmental authority or any person acting or purporting to act under governmental authority shall have taken any action to condemn, seize or appropriate, or to assume custody or control of, all or any substantial part of the property of the Debtor or shall have taken any action to displace the management of the Debtor to curtail its authority in the conduct of the business of the Debtor; or
- f. the Kingdom of Thailand or any legislative, executive or judicial body thereof (whether by a general suspension of payments or a moratorium on the payment of indebtedness or otherwise), or any treaty, law, regulation, communique, decree, ordinance or policy of Kingdom of Thailand shall purport to render any provision of this Agreement invalid or unenforceable or shall purport to prevent or materially delay the performance or observance by the Debtor of its obligations hereunder.

Debtor

At any time after the occurrence of a breach of this Agreement and upon the receipt by the debtor of written notice from the required creditors, the agreement shall terminate immediately as to the debtor without the requirement of any further notice or action. After three unremedied breaches by the debtor, the creditors agree to seek collection of their credits under judicial process and/or immediate liquidation or reorganization of the debtor under new management pursuant to the Bankruptcy Act.

Creditor

With regards to the DCA, if any Creditor under this Agreement (a “Non-Complying Creditor”) fails to comply with Section 9 hereof (Voting on Proposed Plan; Implementation of Approved Restructuring Plan) any other Creditor under this Agreement may report the non-compliance to CDRAC.

Subject to the laws and regulations applicable to financial institutions in Thailand, by virtue of the provisions of this Agreement BOT may take any or all of the following measures with respect to any Non-Complying Creditor

- i. give a warning letter to the Non-Complying Creditor;
- ii. impose a fine on the Non-Complying Creditor as a result of non-compliance. Such fine shall be payable to CDRAC against the operating expenses of CDRAC and its members and shall not exceed 10% of the Non-Complying Creditor’s claims against the Debtor but in no event be less than Baht 500,000.

In the event of any material breach of a provision of this Agreement other than section 9 by a Creditor under this Agreement, any other Creditor under this Agreement may report such breach to CDRAC and CDRAC may issue a warning letter to the breaching Creditor under this Agreement.

As for the enforcement mechanisms under Section 7 of the ICA regarding the Executive Decision Panel, if any Creditor under this Agreement (a “Non-Complying Creditor”) fails to comply with the decisions of the Executive Decision Panel or any other material term or condition herein in relation to a Credit while it is the holder of such Credit, any other Creditor may report the non-compliance to CDRAC and BOT.

Subject to the laws and regulations applicable to financial institutions in Thailand, BOT by virtue of the provisions of this Agreement may take any or all of the following measures with respect to any Non-Complying Creditor

- i. give a warning letter to the Non-Complying Creditor;
- ii. impose a fine on the Non-Complying Creditor as a result of non-compliance. Such fine shall be payable to CDRAC against the operating expenses of CDRAC and its members and shall not exceed 50% of the Non-Complying Creditor’s claims against the Debtor but in no event be less than Baht 1,000,000.

Progress of Corporate Debt restructuring of CDRAC Target Debtors

Since mid-1998 up to 31 September 2002, CDRAC has approved 15,321 cases with credits outstanding of 2,836,816 million baht as 1998-2001 Target Debtors and 2002 Target Debtors. Details of the restructuring up until the end of September 2002 are as follow:

(1) As of September 2002, the total to 10,260 debtors with credits outstanding of 1,363,252 million baht have been successfully restructured. The majority of restructured debtors are represented by the wholesale and retail trade sector with 2,608 cases, followed by the personal consumption sector with 2,438 cases and the industrial sector with 1,606 cases. Details are as follows:

	Total as at 30 Sept. 2002	
	Cases	Mil. Baht
1. 1998 – 2001 Target Debtors	10,126	1,303,233
2. 2002 Debtors	134	60,019
Total	10,260	1,363,252

(2) Debtors that have been unable to successfully restructure their debts under the CDRAC process combined with a total of 3,110 debtors with credits outstanding of 774,176 million baht that did not enter into the CDRAC process in the first place, totals 4,773 target debtors with credits outstanding of 1,189,307 million baht that have been filed in court.

(3) The remaining 202 debtors with credits outstanding of 101,610 million baht are in the restructuring process as at the end of September 2002. All of these cases are the 2002 target cases.

(4) Furthermore, an additional 26 debtors with credits outstanding of 22,985 million baht have been transferred to the TAMC and 60 cases with credits outstanding of 159,662 million baht are performing.

Alternative Restructuring Methods

The cases under the management of CDRAC process have been successfully restructured by various methodologies. While most restructured cases used a combination of more than one method in their debt restructuring plans, some methods are more prevalent throughout the spectrum of restructured cases. As at the end of July 2002, it is observed that most of the cases restructured under the CDRAC process was restructured by means of extension of the loan period (27.3%) followed by 21.7% of debt forgiveness and 17.8% of conversion of debt into equity or other assets by creditors. The following table lists the various debt restructuring methods and the percentage of restructured debt:

	Debt Restructuring Method	Proportion of restructured debt (%)	
		2000	2002 *
1	Upfront payment	13.07	17.29
2	Extension of Loan Period	39.68	27.26
	2.1 With Grace Period for principal or interest	25.40	15.90
	2.2 Without Grace Period for principal or interest	14.28	11.36
3	Conversion of Debt to Convertible Debenture /Convertible Loan/Debenture/Zero coupon Bond	4.51	-
4	Conversion of Debt to Equity or other Assets **	12.50	17.76
5	Debt forgiveness	15.05	21.69
6	Continuation of original Working Capital	8.99	15.88
7	Other credit lines (ie. continuation of credit guarantee)	5.83	0.11
8	Transfer of total debt burden to affiliated company	0.36	-
Total		100.00	100.00

* Preliminary

** Other assets include: real-estate, houses, office buildings, golf courses, machinery, investment capital, claims on debtors

Necessary Dynamics and Environment

Even though the procedures and timeframes are strictly specified in the Agreements, sincere commitment of both the creditor and debtor to work together towards a productive outcome in negotiations is an indispensable factor. All stakeholders commit to a definitive timetable for restructuring, forcing decisions to be made and actions to be taken and the process includes guidelines for all parties to follow, making the restructuring clear and concise. The structured informal process has been significantly assisted by the ICA and DCA through the efficiency enhancement of and the avoidance of unnecessary delays in the process. Never before did Thailand have a speedy and simple restructuring process under definitive guidelines and timeframe. The appointment of an Independent Accountant and Financial Advisor ensures all stakeholders of fair treatment and equal information in support of debt restructuring. The agreements were also innovative in that it allowed for the appointment of an approved mediator in case negotiations reach a deadlock. Companies are able to retain control of their business operations.

Some agreements reached through the CDRAC process would have to be ratified by the court, in order to bring the dissenting creditors into line. Even though it is a quasi-policy body and not a judicial one, its process is voluntary and more flexible than that of the Bankruptcy Court. CDRAC has become the preferred venue for debt negotiations, and has to date restructured a significant amount of loans.

In addition to the Authorities and CDRAC, many other parties are also involved in the voluntary debt restructuring process such as Thai commercial banks, foreign banks, finance companies, finance & securities companies, Export-Import Bank of Thailand, the Industrial Finance Corporation of Thailand, as well as the Financial Sector Restructuring Authority, the Asset Management Corporation, asset management companies, trade creditors and CDRAC's target debtors. Furthermore, the independent advisors and specialists such as financial advisors, independent accountants, engineers and independent valuers are also involved in the in developing the debt restructuring plan and providing expert advice.

Incentives and Triggers in Facilitating Informal Workouts

As the economic crisis severely affected the financial system, commercial banks – both government and private owned – were encouraged to set up AMC's in order to separate the bad assets from the books of the banks. In this way, commercial banks balance sheet would be cleaned and become "good banks", while private AMCs would concentrate their operation on debt restructuring and loan recovery.

Incentive structures were designed to support and attract the resolution of private indebtedness through negotiations in good faith. These included tax exemptions and reductions for the transfer of properties (to encourage debtors to transfer collaterals in payment for the debt), and regulatory changes for NPLs under the new definition of three-months past due (from 12 and 6 months past due) to be allowed for up to 5 accounting periods from end 1998 to 2000. The State's role was concentrated on mediation, through the setting up of the Corporate Debt Restructuring Advisory Committee (CDRAC).

CDRAC is responsible for mapping out debt restructuring measures in support of efficient negotiations in corporate debt restructuring between the debtor and financial creditors or other creditors who signed into the process. CDRAC's debt restructuring process allows for both the debtors and creditors to voluntarily negotiate the debt restructuring under a market-oriented approach. To attract creditors and debtors to come together to resolve their debts voluntarily, the BOT has coordinated with the Revenue Department, the Land Department and other relevant agencies in issuing measures to provide tax exemptions and reduce land-transfer fees for creditors and debtors who successfully restructured their debts that comply with the BOT guidelines.

The Bank of Thailand provides a Corporate Debt Restructuring Group (CDG) as the secretariat to coordinate and facilitate the debt restructuring between parties concerned and operate in accordance with the resolutions of CDRAC. As part of the Bank of Thailand, the CDG is well respected by all financial institutions and other parties concerned. This has significantly aided the restructuring process in bringing all the creditors together to the negotiation table. Without the CDG, some creditors may not cooperate with other creditors. The CDRAC process entails a prior agreement among lending institutions (its members) to abide by certain rules in their negotiations with debtors, for example not to seek recourse to the courts until the avenue of negotiations within CDRAC with its strict time frame is closed.

In 2001, however, there was a shift in strategy towards a more pro-active and centralized resolution of the NPL problem. The Thai Asset Management Corporation – more commonly known as the TAMC - was established on 9 June 2001. It took over a part of NPLs from both private and state banks and now manages about 700 billion baht of non-performing loans, or about less than half of the NPLs in the system. Since then, NPL in the banking system has declined steadily, while banks have gradually turned in profit, specifically pre-provisioning profits. Credit growth has picked up, especially in the consumer loans, housing, infrastructure and utilities sector. Loan repayment continues, reflecting the ongoing de-leveraging in the corporate sector. The capital market, both equity and debt, quickly made headway as the new source of funding. Against this backdrop, bank credit growth has not expanded much, although overall economic activities both in the banking and non-banking sector have improved markedly this year.

The question then is what happens to the NPL remaining in the system and whether these NPLs still pose a risk to the macroeconomic and financial system. In so doing, it may be useful to examine the various parts of the financial system where NPLs are parked. There are NPLs which still remain in the books of commercial banks and finance companies, NPLs that have been transferred to the TAMC, NPLs that are being managed by the AMCs of state banks, and NPLs of private banks. Among these, the remaining NPLs at commercial banks and finance companies pose a threat to the financial institutions' stability while the rest has been well taken care of by the authorities concerned.

As at the end of June 2002, NPLs that remain at commercial banks and finance companies stand at 843 billion baht, down from 2,729 billion baht at the same period in 1999. The current level of distressed assets represents 17% of the total value of credits outstanding in the financial system of 4,757 billion baht. Of the 843 billion baht in distressed assets with commercial banks and finance companies, the entire value has been fully provisioned by the financial institutions. Furthermore, 157 million baht of distressed have recently been restructured and are pending removal from NPL status after three months of debt service according to the restructuring plan.

Of the 716.8 billion baht worth of NPLs transferred to the TAMC, 118.4 billion baht has been restructured by June this year. This leaves 598.5 billion baht worth of debt, 82 billion baht of which is under legal execution, and 516 billion baht under negotiation. The TAMC purchased these debts at 33% of its face value – or equivalent to the underlying collateral value. As the recovery rate is typically higher than net collateral value, no further loss to the taxpayer is expected from these debts. As such, these NPLs are not likely to pose further risk factor to the economy.

NPLs held by the AMCs of state banks stands at about 400 billion baht . These assets were transferred to the AMCs at a relatively high price – somewhat higher than the collateral value. The potential losses from these assets have been accounted for in the estimation of the fiscalization of the losses from financial sector restructuring, and therefore should not pose a risk to the economy.

NPLs held by private AMCs remain at about 140 billion baht, which are in the process of restructuring. Potential losses from these NPLs should remain relatively low as past record of the recovery rate has been high.

In short, the chances that further losses from the resolution of NPLs will pose systemic risk and stall the recovery process are very small. NPLs of commercial banks have been provisioned beyond minimum requirements, while the recovery rate from NPLs in the TAMC should exceed their collateral value. Further losses from NPLs in state-owned AMCs have already been factored in the fiscalization excretes.

Challenges of Informal Workouts

Since economic crisis was more severe than expected and all parties involved in debt restructuring had limited experience and practical knowledge in dealing with such high levels of NPLs in the financial system. Furthermore, the ICA/DCA is used for all target debtors, so there are practical challenges to constructive debt restructuring negotiations when debtors or creditors interpret the ICA/DCA to their advantage and at the cost to other creditors. Like bankruptcy proceedings everywhere, the CDRAC Process faces the problem that creditors' incentives differ greatly among themselves as well as with those of the debtor. In addition to the conflict between secured and unsecured creditors, the financial institutions' incentives to write off debts also differ greatly. This combined with unconstructive attitudes towards the negotiations led to the slow progress in debt restructuring at the initial stage.

Some debtors have misguided attitudes in debt restructuring in that they only want to see the creditors forgive as much of their debts as possible. Loans of other debtors are considered to be 'strategic NPLs' in that the debtor has the ability to make repayments but chooses not to do so. At the same time, creditors aim to limit their losses or suffer no losses at all, fearing the burden of having to make the reserves for loan losses or having to increase their capital. Such attitudes are not congruent with CDRAC's restructuring process, which aims for debtors to be able to continue their business operations in order to make fair repayments to their creditors who should receive more in return than they would from liquidation in the court proceeding. The process of writing down the assets and liabilities of the debtor company should be as speedy as possible, so that it can get on with its business without the disruption caused by a credit constraint. For the macroeconomy, if too many

companies are remain insolvent for too long a period, the recovery from the crisis may be significantly delayed.

Some aspects of Thai business practices and the nature of the crisis combine to slow down this process considerably. The first problem is with respect to the shareholders of the debtor firms. When a reduction in the values of assets and liabilities become necessary, it should be the shareholders' interest that takes the first cut. In the case where the shareholders' equity is reduced to zero, this means their ejection from the company. However, in Thailand, most companies, especially the small- and medium-sized businesses, are family-owned and managed. To eject the owners would raises many problems for the creditors, as they would lose the management as well, thereby losing part of the value of the company. This is therefore, one of the major bottlenecks in the restructuring effort.

Benefits from Informal Workouts

Never before did Thailand have a speedy and simple restructuring process under definitive guidelines and timeframe. While the red-tape and the time-consuming legal technicalities can be avoided through the informal process, participants are able to benefit from a well structured process and standards that ensure fairness to all parties.

The appointment of an Independent Accountant and Financial Advisor ensures all stakeholders of fair treatment and equal information in support of debt restructuring. In many cases, the accounts of a debtor need to be verified by an accepted third party auditor. The Financial Advisor's expertise benefits the financial institutions in alleviating the heavy burden of developing customized and in-depth workout plans for all non-performing creditors. The Legal Advisor ensures that the workout plans comply with laws and are legally enforceable

The informal workout as prescribed by the ICA and DCA were also innovative in that it allowed for the appointment of an approved mediator in case negotiations reach a deadlock. Instead of heading to the court process right away, the parties involved will have the opportunity to resolve their dispute with the help of a mediator. The Executive Decision panel becomes effective for when creditors are unable to reach sufficient plan approval level and is another way of avoiding entry into the court process.

Ultimately, the objective of the informal process of for viable companies to retain control of their business operations and generate income for the repayment of their debts. The potential returns from the informal process more often than not bring about a greater level of returns than the court process that may result in liquidation of the company. In this regard, both the creditors and debtor will benefit from the informal process.

Conclusion

Authorities and the private sector will continue to work closely to resolve the remaining NPLs in the financial sector. The Bank of Thailand is working on the Financial Sector Master Plan to create a blueprint for a competitive financial system. Corporates are regaining health through firm and steady reforms. Meanwhile, sound monetary and fiscal polices are providing the support for continued corporate and financial sector reforms.

29 November 2002