

ADDRESSING THAILAND'S NON-PERFORMING LOANS

By: Cynthia M. Pornavalai

Tilleke & Gibbins International Ltd.

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There is probably no need to remind anyone of that bleak day in July 1997 when the Thai Baht finally succumbed to the pressure and collapsed. That incident triggered off the domino-like fall of a then over-leveraged Thai financial system, and exposed basic structural defects in corporate Thailand. Corporate Thailand was then, as it is now, largely dependent on banks and a number of financial institutions for financing. A chicken-and-egg situation ensued whereby the companies weighed by heavy-debt burden, courtesy of wayward lending and borrowing practices of the 90s, started to collapse one by one on the one hand, and the banks collapsing over the unabated weight of Non-performing loans or NPLs, on the other hand.

NPLs as of July 2001 total Baht 615.06 billion representing 12.69% of total loans in the system. Private banks account for Baht 476.86 billion or 17.95% of total loans, while state banks account for Baht 92.53 billion or 6.39% of total loans. NPLs of foreign banks and finance companies totaled 3.55% or Baht 20.81 billion and 15.98% or Baht 24.86 billion, respectively.

The Thai government was aware that something had to be done to address the paralyzing effect of the heavy NPL situation on the Thai economy. In 1998, the Amendment to Thai Bankruptcy Act which had been in the shelves for more than a decade at that time, was resurrected and finally given life. For the first time in Thailand, a legal regime for court-controlled corporate debt restructuring was set in place. At about the same time the Bank of Thailand (BOT), together with the Thai and Foreign Bankers' Associations and the Board of Trade initiated an out-of-court debt restructuring guidelines modeled after the London approach and the HKMA Guidelines. A year later, in 1999, another Amendment to the Bankruptcy Act was enacted to refine the 1998 Amendments. The BOT, together with local financial institutions also took further initiatives in encouraging corporate debt restructuring by formulating a binding framework in the form of Debtor-Creditor and Inter-Creditor Agreements. The BOT's CDRAC or Corporate Debt Restructuring Advisory Committee coordinated the restructuring efforts under the DCA and the ICA by identifying the debtor and

creditor groups and setting up the venue for the dialog and negotiations between these two groups.

As at the end of September 2001, a total of 989 bankruptcy and business rehabilitation cases involving a total debt amount of Baht 200.95 billion have been filed with the Central Bankruptcy Court, compared to 986 cases involving Baht 58.2 billion for the whole of year 2000. CDRAC, on the other hand has helped restructure 439,276 cases since its inception 2 years ago, involving debts totaling Baht 2.3 trillion.

Although the figures can be impressive, the restructuring process that ensued under the Amended Bankruptcy Act and the CDRAC framework was painstaking. After some time it became obvious that the effort in abating the NPLs was like a Russian dance: two steps forward, and one step back. The millennium buzzword “restructuring”, people started to realize, is actually debt rescheduling. The banks simply managed to defer the NPL problem on the hopes of economic recovery. With such economic recovery unfortunately not forthcoming as expected, the restructured NPLs relapsed. [For example, in July 2001, new NPLs totaled Baht 16 billion, while restructured loans turning bad again totaled Baht 23.6 billion]. More worrying, however, is that new breed of species, the “strategic NPLs”, spreading fast like virus.

TAMC

Declared as Thailand’s last chance to clean up its NPL mess, the Emergency Decree on Thai Asset Management Corporation, or TAMC Decree came into force on June 9, 2001. With all the good intentions but crippled with hastily drafted and obscure provisions, the TAMC Act has been riddled with criticisms and even a legal suit on its constitutionality. Finally clearing its constitutional hurdles on October --, 2001, the TAMC started accepting its first lot of asset transfer last October 15, 2001.

Essentially, what is a TAMC and what is it empowered under the Act?

Rational for establishing TAMC

The rational for establishing a national asset management corporation is in order for the government to address the high level of NPLs in both state-controlled and private financial institutions and to set the environment right for the banks to recommence lending.

Structure

The TAMC is a government agency owned 100% by the Financial Institutions Development Fund (FIDF). TAMC will issue Baht 170 billion (approximately US\$ 3.7 billion) 10-year notes guaranteed by the FIDF to financial institutions as payment for TAMC's purchase of NPL assets from these financial institutions. The TAMC is managed by a Board of Directors consisting of no more than 11 members appointed by the Minister of Finance and approved by the Council of Ministers.

Objectives and Powers

Basically, the TAMC is tasked with the acceptance of transfer of sub-quality asset and its management. Towards the realization of such objectives, TAMC has unprecedented encompassing powers, such as establishing of limited companies, guaranteeing credit for debtors, and lending money to debtors.

Mechanics

1. Transfer of Assets

a. NPLs that can be transferred

All state-owned financial institutions and asset management companies are required to transfer all NPLs falling under the following categories as at December 31, 2000:

- "loss" (required to be written off);
- "doubtful of loss" (requiring 100% provisioning);
- "doubtful" (requiring 50% provisioning); and
- "sub-standard" (requiring 20% provisioning)

Private financial institutions and asset management companies may transfer NPLs to TAMC only under the following circumstances:

- the NPLs are secured by property;
- the debtor which is a juristic entity is indebted to at least 2 Thai financial institutions;
- the total value of NPL owed by a debtor is at least Baht 5 million; and
- no resturcuturing agreement in writing has been entered for the NPL by July 9, 2001, and the NPL is not part of a rehabilitation plan approved by the Bankruptcy Court before June 9, 2001.

Trade creditors, non-Thai banks and their branches are not eligible to transfer their NPLs to the TAMC.

b. Pricing

The price of the assets payable by TAMC to the State Banks is the value of the collateral excluding personal guarantees. The rules prescribed by the TAMC Board shall determine the price to be paid if there is no collateral.

The price payable to private banks that opt to transfer NPLs to TAMC is (a) the value of the collateral (excluding personal guarantees), or (b) the book value of NPL less applicable reserve amount, whichever is lesser. Book value here means the total principal amount of the loan as at the date of transfer together with accrued interest for the 3-month period prior to the transfer date.

If the collateral is land, its value is deemed to be the assessment price used by the Land Department in the calculation of land transfer fees.

c. Profit and Loss Sharing

Profit and loss will be shared as follows:

Profit:

- first 20% - shared equally between TAMC and the financial institution;
- additional profit not exceeding the difference between the book value and transfer price will accrue to the financial institutions;
- any further profits will accrue to TAMC.

Loss:

- first 20% of transfer price – absorbed solely by financial institutions;
- second 20% - equally shared by TAMC and financial institution;
- remaining loss- absorbed by TAMC.

2. Debt Restructuring

One of the most interesting powers of the TAMC is its ability to restructure the debt by unilaterally amending loan terms, forcing a debt-equity conversion (despite the absence of

similar mechanism under present laws), taking assignments of debts or assets from the debtor to settle debts, and taking transfer of shares or buy issued shares to increase the debtor's capital. For all these and other measures, only the approval of the TAMC Board is required. Certain procedures required under relevant laws are generally waived.

3. Business Reorganization

The TAMC Decree sets forth the rules and procedures of business reorganization separate from those provided under the Bankruptcy Act. The criteria for business reorganization under the TAMC Decree are as follows:

- the debtor must be a limited company, a public limited company or a registered partnership;
- TAMC is a creditor and is owed more than 50% of the debtor's total debt;
- There is evidence that the business can be carried on and its rehabilitation will benefit the national economy;
- The debtor consents and agrees to be bound by the terms and conditions of business reorganization under the TAMC Decree.

The TAMC Executive Committee appoints the planner who is tasked to draft the plan within the time limit set by TAMC. Once the Executive Committee and the TAMC Board approves the plan, the TAMC shall file a petition with the Bankruptcy Court for it to consider the plan. From the date of court approval of the plan to the completion of business reorganization, the automatic stay similar to that under the Bankruptcy Act is applied.

The plan may require merger of debtor's businesses, closure of part of the business, payment of other creditors participating in the business reorganization, and other measures approved by TAMC Board. In these circumstances, certain provisions under Civil and Commercial Code (CCC) and the Public Company Limited Act are waived.

Schedule

The first batch of NPLs transferred to TAMC on October 15, consists of debtors with one creditor and debts of over Baht 50 million. There are about 1,100 debtors in this category with debts totaling Baht 300 million. The second batch of NPLs worth about Baht 400 billion will be transferred at the end of October 2001. This category consists of debtors with 2 creditors, mostly, state and private financial institutions. The third batch of loans which will be transferred in November, will involve the remaining 4,000-6,000 debtors with two or more

creditors and total debts of about Baht 220 billion. It is expected that approximately 77% of the total NPLs in the banking system will be removed once these three batches have been completely transferred.

Assessment

Promising as these figures might appear, there seems to be little enthusiasm today towards the TAMC. [As at early October 2001, twelve financial institutions with a total of Baht 38.8 billion in NPLs declined to participate in the TAMC program.] Bankers do not think of it as a panacea to the NPL problem. An academic fears that the TAMC will be a vehicle to “warehouse” the NPLs forever, and see its value as limited only to the state banks which must get the NPLs off their books.

It is unfortunate that the inherent problems which make NPLs thrive, remain, i.e., Thailand’s weak foreclosure and bankruptcy laws, limited security/collateral laws, weak corporate governance standards, deteriorating credit culture, and weak prospects for early economic recovery. Injecting more capital into the system, obviously, is not the answer. Thai banks are sitting on large surplus liquidity, but they have also learned their lessons.
