SM/01/232
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

August 7, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **Thailand—Selected Issues**

The attached corrections to SM/01/232 (7/19/01) have been provided by the staff:

Page 15, para. 22, last line: for "However, under certain situations, the regulations allow banks to take into account…"
read "However, in line with international practice (FAS114), the regulations allow banks to also take into account…"

Page 16, para. 23, lines 4 and 5: for "…reclassification. Such immediate reclassification opens the possibility…"
read "…reclassification. Even though the specified criteria allowing immediate reclassification aim to ensure that the underlying restructuring is of good quality, this clause opens the possibility…"

Questions may be referred to Mr. Haksar (ext. 37157), Mr. Jonsson (ext. 34266), and Mr. Barnett (ext. 34439).

Att: (2)

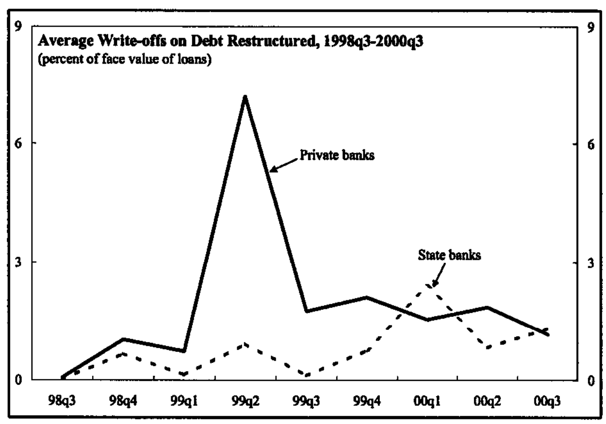
Other Distribution:
Department Heads

the Bank of Thailand to facilitate debt restructuring, especially in large multi-creditor cases. At its peak, CDRAC was overseeing debt restructuring cases with a value approaching 50 percent of GDP. Of this, over half of the cases have been successfully restructured, though as noted earlier, the sustainability of these restructurings is yet to be borne out. Further, just under half of the cases, worth some 25 percent of GDP, remain to be resolved, and risk devolving on to the already burdened civil court system. Moreover, some of the successfully restructured debt was held by non-resident creditors and thus would have no impact on the measures of NPLs and distressed assets that pertain to the domestic banking system.

21. **Debt restructuring by commercial banks appears to have largely involved rescheduling with little deleveraging of borrowers.** Comprehensive data on the nature and quality of debt restructuring conducted by banks are not available. This in part reflects the inherent complexity and variety of methods used in debt restructuring deals. Nonetheless, information put together by the BOT on the nature of debt restructuring conducted in a sample of cases indicates that rescheduling, grace periods on debt service, and some interest rate reduction are the most commonly found components of debt restructuring deals (Text Table). The first two methods have in practice typically been crafted in such a fashion as to not imply much net present value (NPV) reduction in the value of the debtor's obligations.

Breakdown of Loan Restructuring Methods for Thai Banks
(percent of cases using at least one of the below methods)

	1999	2000
Debt rescheduling	41	41
Grace period on debt repayment	20	21
Interest rate reduction	22	20
Principal or accrued interest reduction	6	6
Debt-to-assets swap	6	5
Debt-to-equity swap	3	4
Others	2	3
Source: Bank of Thailand		



While interest rate reductions could in principle imply some reduction in the effective debt burden, anecdotal evidence suggests that here also, many deals involve a reduced interest rate for the first 2-3 years of the revised agreement, with above prime rates for the remaining loan period such that there is no NPV loss to the bank. This is corroborated by the fact that banks have in general reported very low NPV losses on restructured debt (Text Figure). In particular, reported NPV losses on debt restructured by commercial banks during 1998q3-2000q3, averaged only 1.8 percent of the face value of debt restructured by private banks and 0.9 percent on restructuring by state-owned banks.

22. **BOT guidelines require banks to fully reserve against losses from debt restructuring, but implementation may be uneven.** Under troubled debt restructuring (TDR) guidelines, the loss on TDR should preferably be based on the NPV reduction in projected cash flows. In most cases banks do appear to use cash flow models to determine the actual NPV loss from TDR (which given the factors discussed in the previous paragraph, is typically low). However, ~~under certain situations~~in line with international practice (FAS 114), the regulations allow banks to also take into account the collateral value supporting the

restructured loan (subject to BOT appraisal requirements). Given concerns with collateral valuation (discussed above), this could result in understated losses on TDR.

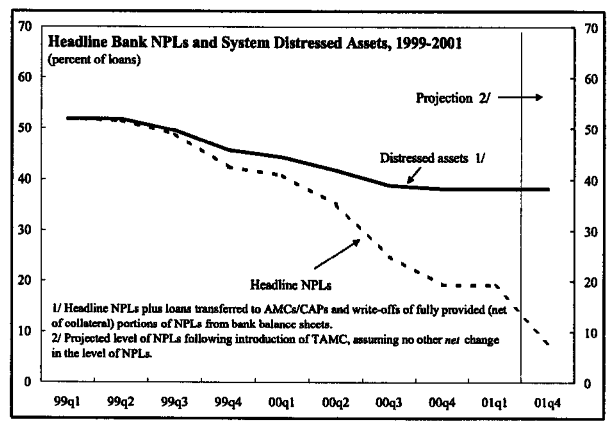
23. **BOT guidelines also allow restructured loans meeting certain criteria to be immediately reclassified as pass.** This is generous by international standards—typically at least 3-6 months of conformity with the revised debt service agreement is required before reclassification. Even though the specified criteria allowing immediate reclassification aim to ensure that the underlying restructuring is of good quality, ~~Such~~ this clause ~~immediate reclassification~~ opens the possibility for banks to prematurely reverse provisions on these loans (some weaker banks have already reversed such provisions into income). In an environment where re-entry of previously restructured NPLs is rising, this could be of particular concern.

24. **Slow progress in debt restructuring reflects the large scale of the problem and weaknesses in the legal framework.** Importantly, creditors' power to enforce their claims is undermined by the weak legal framework for bankruptcy and foreclosure (these issues are discussed further in Chapter IV). This creates disincentives for banks to make concessions to deleverage borrowers. For example, it is difficult for creditors to force recalcitrant borrowers to cede some control of their companies in the context of debt for equity swaps. Often, standoffs arise with neither side making the concessions necessary for equitable and sustainable debt restructuring to arise. Also, banks concerned about their capital position and faced with a difficult legal environment, attempt to minimize their upfront losses and the concomitant impact on capital. This can result in a protracted period of negotiation, and may not lead to sufficient deleveraging of the corporates, which in turn could further prolong the debt restructuring process.

A. Outlook and Key Risks for the Banking System

Near term outlook

25. **Responding to the slow progress in deleveraging of the corporate sector, the authorities have decided to establish a national AMC.**[9] The Thai Asset Management Corporation (TAMC) is expected to take on about ½ of system-wide distressed assets, mostly from the state banks. The headline NPL figure for the overall banking system should fall substantially (Text Figure), to around 10 percent of all loans once the TAMC has completed the process of acquiring NPLs,



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[9] Chapter III provides a detailed description and assessment of the structure of the TAMC, including details on the impact of the TAMC on private banks.