

# **Thailand's Financial Sector Master Plan Handbook**

**Bank of Thailand**

## MESSAGE FROM THE GOVERNOR

It is generally accepted that although the 1997 financial crisis started from disequilibria in the currency market, it was the weaknesses within Thailand's financial system, previously masked by rapid economic growth that intensified the economic recession. Thailand has undertaken numerous policy measures to restore stability to the financial system such as closing of nonviable banks and finance companies, recapitalization of the financial institutions by both private and public initiatives, debt restructuring and resolution, asset liquidation, and the consolidation of weak financial institutions with stronger ones. Complementary to these efforts, the Bank of Thailand has also engaged in dramatic internal reforms that resulted in the realignment of its organization structure with the new risk-based supervisory framework.

The return of banking profitability in 2001 signaled a turnaround of the crisis and an opportunity to focus on developing a financial system. The new goal is to provide the system with sufficient resiliency to withstand new competitive forces brought about through trade liberalization and appropriation of traditional banking services by non-bank entrants. The growing availability of new financial services and technology that allows risk to be priced, diversified, and shared cross borders further requires a modernization of both players and supervisors. Business wise, this meant employing comprehensive risk management tools, IT systems and continuing efforts to strengthen banking income through cost-cutting measures, improved credit underwriting standards, and new income channels such as fee-based services and retail banking. To assist these initiatives, integral commercial banking laws, regulations as well as supervisory efforts are also being updated, thereby enhancing supervisory flexibility and adaptability suitable for rapid financial innovation.

In terms of structure, these efforts entailed the streamlining of Thailand's financial institution system and development of a coherent context with which to chart future progress. This resulted in the joint effort between the Bank of Thailand and Ministry of Finance (MOF) to formulate the Financial Sector Master Plan (FSMP) as the medium-term development plan for financial institutions under the supervision of the Bank of Thailand. The main thrust of the FSMP entails the re-engineering of the financial institution landscape through the promotion of competency driven consolidation and modification of relevant prudential guidelines. These developments in turn provide commercial banks with more flexibility to position themselves that best leverages their expertise and strategic preference. As a roadmap for development, the FSMP provides a framework to facilitate the evolution of financial services and future increases in competition.

The intention of this Handbook is to offer readers an insight into the assumptions and rationale that underlie the future direction of Thailand's financial sector. The recommendations within the FSMP are neither fixed nor posed as definitive answers to financial sector development. Yet mutual understanding fostered by this Handbook will allow relevant stakeholders a common platform for future dialogues and exchange of ideas. This will be highly useful for the next phase of the FSMP whereby

further liberalization and deregulation depend upon the results of impact and competitive studies on the FSMP's phase one implementation. It is our hope that the outcomes derived from this project will lay the foundation for a stable financial sector that is responsive to the genuine economic and development needs of Thailand's dual economy.



M.R. Pridiyathorn Devakula  
Governor  
Bank of Thailand  
24 August 2006

## OVERVIEW

The 1997 financial crisis and its subsequent economic fallout highlighted many deficiencies within Thailand's financial system. Since that time, relevant government authorities, together with private sector players, have instituted deep-rooted reforms aimed at halting the economic contraction, restore investor confidence, and return the financial sector to a sustainable development path. One of these initiatives was the Financial Sector Master Plan (FSMP), a 5-10 year medium-term development plan for financial institutions under the supervision of the Bank of Thailand.

For the purpose of this Handbook, **Chapter 1** guides the reader through the deliberation process and rationale behind the initiation of the FSMP, in addition to the methodology used to promote public participation in the project. **Chapter 2** focuses on how authorities formulated the FSMP's three main objectives, its complementary policy recommendations and action plans using factual data deduced from surveys, focus groups, and research studies. **Chapter 3** then provides an update on the progress of implementation so far, while the appendices provide readers with background material such as the Governor's speech and summaries of the result from the nationwide survey concerning households and corporate perception of current financial services. The appendices in turn offer helpful insights into the rationale, research and surveys that formed the basis of the FSMP.

## FINANCIAL SECTOR MASTER PLAN TIMELINE

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June 2000	<ul style="list-style-type: none"><li>• Financial Institutions Policy Board (FIPB), chaired by former Governor M.R. Chatu Mongol Sonakul, instructs the Financial Institutions Policy Group (FIPG) to perform cross-country comparative study of banking regimes.</li></ul>
July 2000	<ul style="list-style-type: none"><li>• FIPB briefed on result of study titled “<i>Strategy and Future Direction for Finance Company and Credit Foncier Company,</i>” by Mr. Jim Lasey, technical assistant from the World Bank.</li></ul>
November 2000	<ul style="list-style-type: none"><li>• FIPG performed additional cross-country analysis on trends in financial services, scope of permitted services, possible structure of financial conglomerates, types of regulatory regime, and regulatory cooperation.</li></ul>
February 2001	<ul style="list-style-type: none"><li>• FIPB determined that financial sector development should entail both market and supervisory reforms, with relevant stakeholders involved in the development of optimal financial system structure through selected committees and formal public hearings.</li></ul>
April 2001	<ul style="list-style-type: none"><li>• Eminent persons meeting identified topics for further studies and preliminary long-term vision for Thailand’s financial sector.</li></ul>
June 2001	<ul style="list-style-type: none"><li>• FIPG proposed work plan for the Recommended Structure for Financial Institutions Project (Project) to Governor M.R. Pridiyathorn Devakula, based on procedures used by the National Economic and Social Development Board (NESDB) to draw up Thailand’s Ninth Economic and Social Development Plan.</li></ul>
July 2001	<ul style="list-style-type: none"><li>• Coverage of the Project was reduced to envelop only financial institutions under the supervision of the Bank of Thailand.</li></ul>
August 2001	<ul style="list-style-type: none"><li>• Governor M.R. Pridiyathorn Devakula directed FIPG to study the financial system of countries with economic structure similar to Thailand’s dual economy, and to focus on improving financial services to urban, rural and microfinance consumers.</li></ul>
January 2002	<ul style="list-style-type: none"><li>• Seminar on “Modernizing Our Financial System: Challenges for the New Millennium,” with guest speakers from Australia, Canada, Hong Kong, and South Africa</li></ul>
February 2002	<ul style="list-style-type: none"><li>• Bank of Thailand established the Financial Sector Master Plan (FSMP) Committee to finalize vision and objective of the Master Plan.</li></ul>
August 2002	<ul style="list-style-type: none"><li>• CSN &amp; Associates Company Limited engaged to perform nationwide survey to gauge consumer and corporate satisfaction with available financial services.</li></ul>

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September 2002	<ul style="list-style-type: none"> <li>● McKinsey &amp; Company appointed to produce an international benchmarking report that would act as an input for the policy recommendations under the FSMP.</li> </ul>
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May 2003	<ul style="list-style-type: none"> <li>● Financial Sector Master Plan Committee finalizes FSMP recommendations.</li> </ul>
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July 2003	<ul style="list-style-type: none"> <li>● Bank of Thailand officially submitted Ministry of Finance on details of the FSMP as proposed by the FSMP Committee.</li> </ul>
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December 2003	<ul style="list-style-type: none"> <li>● Ministry of Finance proposed the FSMP to the Council of Ministers</li> </ul>
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January 2004	<ul style="list-style-type: none"> <li>● Council of Ministers acknowledges FSMP thereby initiating Phase I of the FSMP</li> <li>● Ministry of Finance and Bank of Thailand issues notifications and circulars regarding rules and procedures concerning application for commercial bank license, branch or subsidiary of foreign bank, and One-presence policy</li> <li>● Minister of Finance established the Committee to review application to establish a commercial bank in accordance with the Financial Sector Master Plan.</li> <li>● Bank of Thailand presented details of the FSMP to representatives of financial institutions under the supervision of the Bank of Thailand.</li> </ul>
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February-July 2004	<ul style="list-style-type: none"> <li>● Interested financial institutions submitted applications for new license and/or plan to comply with One-Presence policy.</li> </ul>
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November 2004	<ul style="list-style-type: none"> <li>● Committee to review application to establish commercial bank in accordance with the FSMP forwards the last remaining application to the Minister of Finance for approval.</li> </ul>
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December 2004	<ul style="list-style-type: none"> <li>● Minister of Finance announced approval for nine applications to establish commercial banks under FSMP.</li> </ul>
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April 2005	<ul style="list-style-type: none"> <li>● Minister of Finance announced approval of one application and rejection of three applications to establish commercial banks under FSMP.</li> </ul>
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July 2005	<ul style="list-style-type: none"> <li>● Minister of Finance approved all One-presence applications.</li> </ul>

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## CHAPTER 1: WHERE DO WE GO FROM HERE?

*“One of the roles of the financial regulator is to formalize processes and frameworks so as to guard against market disorder.” Dr. Tarisa Watanagase, Deputy Governor, Eminent Persons Group Meeting, April 2001*

The first signs that financial institutions were resuming normal financial business occurred in 2000 as remaining finance companies began to submit applications to the Bank of Thailand asking for permission to expand their scopes of business into credit cards and loan servicing business. In the pre-crisis world, relevant departments within the Bank of Thailand would vet such requests and submit formal positions to senior management for final approval in a timely manner. But in the post-crisis period, where the majority of finance companies suffered irreparable losses from their disproportionate exposure to the real estate sector relative to commercial banks, authorities questioned the suitability of reviewing and approving requests on a case-by-case basis relative to looking at the scope of business in its entirety.

**TABLE 1: FINANCIAL INSTITUTIONS UNDER SUPERVISION OF THE BANK OF THAILAND**

<b>Pre-Financial Crisis January 31, 1997</b>	<b>Post-Financial Crisis December 2003</b>
<ul style="list-style-type: none"> <li>• Commercial Banks (31)               <ul style="list-style-type: none"> <li>➢ Locally-incorporated (15)</li> <li>➢ Foreign bank branched (16)</li> </ul> </li> <li>• International Banking Facilities (IBFs) attached to commercial banks (25)</li> <li>• Stand-alone IBFs (17)</li> <li>• Finance and Securities Companies (91)*</li> <li>• Credit Foncier (12)</li> </ul>	<ul style="list-style-type: none"> <li>• Commercial Banks (31)               <ul style="list-style-type: none"> <li>➢ Locally-incorporated (13)</li> <li>➢ Foreign bank branched including hybrid banks (18)</li> </ul> </li> <li>• International Banking Facilities (IBFs) attached to commercial banks (24)</li> <li>• Stand-alone IBFs (5)</li> <li>• Finance Companies (18)</li> <li>• Credit Foncier (5)</li> </ul>
<b>Total Number of Financial Institutions: 176</b>	<b>Total Number of Financial Institutions: 83</b>

Source: Bank of Thailand

\* As of December 31, 1996

The crux of the matter basically boiled down to a need to determine the appropriate role of small financial institutions in the Thai financial landscape, and to address pending issues raised by domestic and foreign financial institutions including the future scope of business, organizational structure and efficiency of financial institutions, and establish complementary supervisory regime capable of supporting, and not impeding, financial stability and soundness. To address these concerns, the Financial Institutions Policy Board (FIPB)<sup>1</sup> initiated the ‘Recommended Structure for Financial

<sup>1</sup> Comprised of Governor of the Bank of Thailand as Chairman, Deputy Governor Financial Institutions Stability, Deputy Governor Corporate Support Service, Advisor to the Governor, Assistant Governor of the Financial Markets Operations Group, Assistant Governor of the Financial Institutions Policy Group, Assistant Governor of the Supervision Group, Assistant Governor of Legal, Assistant Governor of Strategic Capabilities, Senior Director of the Information Technology Group, Senior Director of the Data



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Institutions Project,' in 2000 with the purpose of formulating the long-term strategy for Thailand's financial system, inclusive of all sectors, that would guide public and private sector policies.

## **I. METHODOLOGY AND PROBLEM IDENTIFICATION (June 2000-2001)**

In its first manifestation (June 2000-2001), the project's emphasis was divided into two parts namely market and supervisory reform. This dichotomy required analysts to research leading financial markets and comparable peer, in order to distinguish international financial trends and identify potential roles of deposit-taking financial institutions, scope of business for each type of financial institution, possible structure for conglomerates and universal banks, and the matching supervisory regime and inter-agency coordination.

Together with the above activities, preliminary domestic stocktaking was undertaken to ascertain shortcomings within each segment of Thailand's financial system. This included third party examination of the future direction of finance companies and credit fonciers, surveys of service providers and corporate users, and a system wide SWOT<sup>2</sup> analysis.

As to be expected from a financial system that had undergone drastic economic troughs, the studies revealed numerous inherent weaknesses and gaps in financial services that needed to be addressed if Thailand is to prevent the reoccurrence of 1997, and keep up with international financial trends. For example, financial institutions' survey responses revealed that unclear rules and problems with interest rate benchmarking tools were obstacles staunching capital market growth, while results of the SWOT analysis showed how inadequate internal risk management practices and tools left financial institutions unable to adequately measure, monitor and manage their material risks.

The findings from these initial cross-country studies, surveys and SWOT analysis were later used as background information for discussions by the Eminent Persons Meeting,<sup>3</sup> made up of financial experts from supervisory agencies, financial institutions, large domestic conglomerate, and academia. Given the disparate nature of Thailand's financial system, coupled with the fact that this was only the first round of discussion, much of the group's proposals were fragmented. Nevertheless it was agreed that with the right background information, a forum of experts could help crystallize the project's objective and vision.

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Management Group, Director of Supervision Department 1, three outside financial experts, and Senior Director of the Financial Institutions Policy Department as director and secretariat.

<sup>2</sup> Strength, Weakness, Opportunity and Threat analysis.

<sup>3</sup> Held in April 2001 and attended by M.R. Chatu Mongol Sonakul former Governor of the Bank of Thailand as Chairman, Secretary-General of the Securities and Exchange Commission, Mr. Chulakorn Singhakovin (President and CEO, Bank of Asia Plc.), Mr. Bantoon Lamsam (Chief Executive Officer, Kasikorn Bank Plc.), Mr. Siwaporn Dardarananda (Finance Expert), Mr. Pakawat Kovitwattanapong (Managing Director, Trinity Wattana Co. Ltd.), Dr. Pisit Leehtam (Academic), Dr. Anya Khanthavit (Professor of Finance and Banking, Thammasat University), and Mr. Padungdej Indralak (Corporate Treasurer, Siam Cement Co. Ltd.)



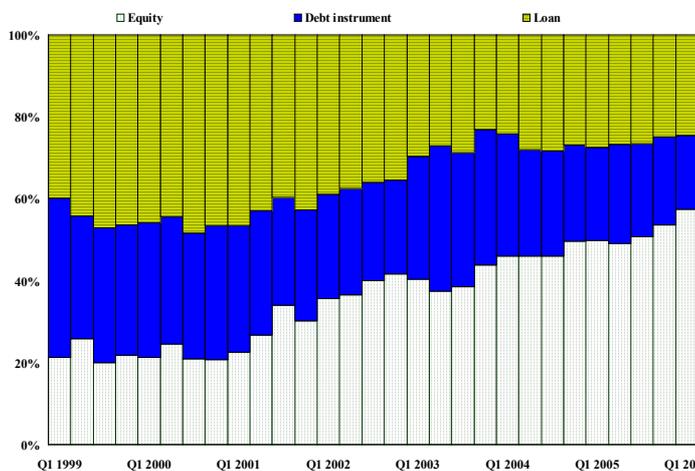
Another endearing recommendation that originated from the discussion was the proposal to invite greater public participation using the methodology applied by the National Economic and Social Development Board's (NESDB) to draw up Thailand's Ninth National Economic and Social Development Plan.<sup>4</sup> Prior to this, financial sector development often applied the top-down approach dominated by regulators and policy makers. The procedure used by the NESDB on the other hand opens the door for a bottom-up approach by soliciting public comments and debates via hearings and focus groups. Using this methodology, researchers would therefore be able to capture and distill complex issues into manageable topics while at the same time generating proposals that respond to actual market and grass-root demands.

## II. MODIFICATION OF METHODOLOGY

The need to develop a comprehensive financial sector development plan did not recede following the transfer of governorship of the Bank of Thailand from M.R. Chatu Mongkol Sonakul to M.R. Pridiyathorn Devakula in May 2001. Governor M.R. Pridiyathorn was a key participant in the Eminent Persons Meeting held in April 2001, and took up the top post at the Bank of Thailand with the view that the project should remain on the agenda but with a more focused scope and objective that better reflects Thailand's environmental limitations and economic reality.

### Reengineered Scope: Tackling the Dominant Banking Sector

Chart 1: Composition of Domestic Financing



The project's scope was reduced from encompassing the entire Thai financial system to covering mainly deposit-taking financial institutions under the supervision of the Bank of Thailand, namely commercial banks, finance companies, credit fonciers, and international banking facilities.

Several compelling reasons substantiated this amendment. First, even though there are some signs that the role of commercial bank loans has been slowly declining over-time (Chart 1), Thailand is still considered a bank-based economy whereby financial institutions under the supervision of the Bank of Thailand dominate the financial sector. Given this reliance on commercial bank financing, Thailand's economy as a whole is bound to benefit from policies that improve efficiency and ability of deposit-taking institutions to offer innovative products at competitive prices.

Second, as commercial banks' started to return to profitability in 2000 (Chart 2) and less preoccupied with internal restructuring, the situation was right for authorities

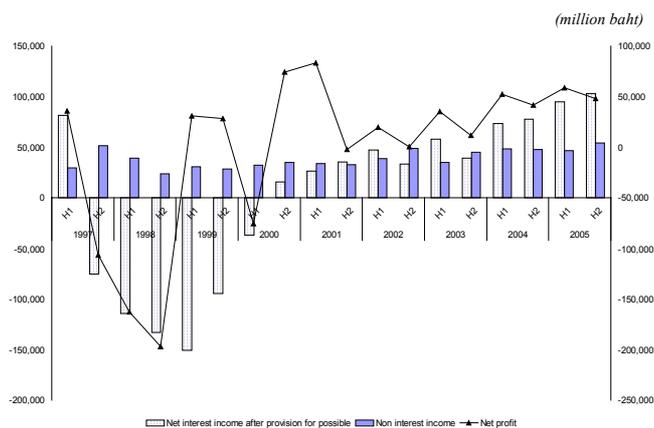
<sup>4</sup> The Bank of Thailand received advisory assistance from Dr. Utis Kaothien of the NESDB.



to pursue dramatic market reforms. Third, with commercial banks having the biggest and most widespread distribution channels relative to other types of financial institutions, they offer a powerful tool for providing financial services, such as securities and insurance, to various underserved communities nationwide. Lastly, any development plan that covered the capital market would be potentially duplicate the Stock Exchange of Thailand's (SET) Capital Market Master Plan.

### Expansion of Objective: Focusing on the Underserved

Chart 2: Commercial Banks' Performance 1997-2005



Adding a new dimension to the project was the expansion of objective beyond purely increasing efficiency of the modern sector to also address the needs of Thailand's dual economy and the urban and rural underserved communities.

Different from Singapore and Hong Kong, Thailand's unique economy is characterized by the coexistence of highly industrialized and modern urban manufacturing sector with a traditional sector outside Bangkok, employing the majority of the workforce, which account for a relatively small portion of the country's GDP.<sup>5</sup> Thailand therefore needs a financial system that can use market forces to support feasible rural development policies and uplift rural income.

Following this policy shift, the project's emphasis was divided into urban and rural parts. The latter of which entailed cross-country studies of countries with economic profiles similar to Thailand such as South Africa and Bolivia together with internal analysis of the role of government-owned specialized financial institutions (SFIs)<sup>6</sup> and the manner with which private commercial banks and/or market forces can profitably cater their services to the underserved.

### III. FROM PROJECT TO FINANCIAL SECTOR MASTER PLAN (FSMP)

With a clear scope and objective, the Bank of Thailand invited international experts to share their knowledge of financial sector development plans and new market challenges with local public and private sector practitioners. Up to that time, there had been a growing consensus among supervisors that carefully deliberated development plans offered a structured long-term approach to financial sector development. Although the objectives of each plan vary from one another given each country's

<sup>5</sup> As of September 2001 Thailand's agriculture sector accounts for 51% labor employment and 10% GDP.

<sup>6</sup> The Bank for Agriculture and Agricultural Cooperatives (BAAC) and the Government Savings Bank are examples of SFIs.



different levels of economic development, financial innovation, and regulatory regime, Thailand could still benefit from the experiences of countries that have already developed and implemented their respective plans.

The Bank of Thailand subsequently organized the seminar on “Modernizing Our Financial System: Challenges for the New Millennium,” in January 2002 with guest speakers made up of financial experts who have direct experience developing financial sector development plans for Australia and Canada, as well as experts on international financial trends, and microfinance in South Africa. (Please see Governor M.R. Pridiyathorn Devakula’s Opening Remarks in Appendix B) Through the seminar, the Bank of Thailand received numerous useful ideas and list of relevant financial issues to help guide Thailand’s approach toward financial sector improvements. (Lessons Learned from Seminar is in Appendix C)

Beyond learning about the methodology for formulating a comprehensive financial sector development plan, participants also discussed the forces of change at work in the international financial landscape (please see Box 1). Being a small market-oriented open economy with financial linkages to the international financial markets, it is of utmost importance for Thailand’s domestic financial institutions to be alert to the global changes and incorporate the lessons learned into their competitive strategies. The global forces of change bring both opportunity and challenges, and the key to a successful strategy is to harness these forces to create products, services, and business models that increase value to the financial sector. Financial institutions should therefore be capable of adapting to changing international norms and act as stable mediums for allocating financial resources and risk among various sectors vital to Thailand’s overall economic and social development goals.

It became apparent after the seminar that Thailand could also benefit from a comprehensible financial development roadmap that encapsulates key lessons learned. Thus, the Bank of Thailand embarked on the Financial Sector Master Plan project that can aims to articulate the medium-term (5-10 years) development vision for Thailand’s financial sector and whose implementation still continues today.



## BOX 1 : INTERNATIONAL FORCES OF CHANGE

(1) **New Technology:** Introduction and application of new technological tools have created more convenient and efficient channels of delivery thereby paving the way for new types of players such as E-banking service providers. With these new tools, financial service providers are no longer inhibited from providing their services purely by physical barriers, but rather they can now access new potential customers with just a few computer keystrokes.

(2) **Liberalization and Deregulation:** The global trend towards further liberalization and deregulation continues to heighten the level of competition and improve efficiency among local and international players. The challenge for regulators then concerns the ability to harness the benefits of liberalization and deregulations in support of economic growth, while minimizing potential adverse consequences with sufficient regulatory oversight.

(3) **Increasing Customer Sophistication:** Given entry of new financial players and introduction of new channels of delivery, consumers now have access to a myriad of financial products and services. With new investment products competing with traditional savings instruments, the challenge for financial service providers will relate to their ability to re-orient their business operations to better respond to more sophisticated customer demands.

These evolutionary forces of change have in effect increased competition from non-traditional players, encouraged intra-industry consolidation, and increased performance pressures on financial institutions to innovate due to falling profit margins. Some examples of the material impact from the forces of change on Thailand are as follows:

**A. Disintermediation and Securitization:** Commercial banks are being bypassed as the traditional providers of credit and savings products either by the market or other non-intermediary institution. Some new players do not provide financial products but rather serve as information channels between customers and a variety of financial service providers thereby becoming a new type of intermediary.

**B. Disaggregation and Reaggregation:** Global forces are breaking up and reassembling companies in ways that enable new entrants to serve commercial bank customers often more effectively and efficiently than traditional providers. They are able to do this because they design their business systems around specific customer and market needs rather than around regulatory or geographic barriers. In essence, global forces are enabling new entrants to pool together parts of the business system and create new types of intermediation, i.e. electronic marketplaces/intermediaries.

**C. Intra-industry Consolidation and Convergence:** Institutions have found it easier to grow and meet stock market expectations through these external means rather than through slow organic growth.

## CHAPTER 2: VISION QUEST & POLICY RECOMMENDATIONS

*“We are not aiming to be the most efficient financial institution network. But we are aiming for a financial system that is most beneficial to Thailand’s economic development, especially for the rural areas that have been left behind.”*  
 Governor M.R. Pridiyathorn Devakula, December 2002

Following the successful conclusion of the seminar in January 2002, the Bank of Thailand established the Financial Sector Master Plan Committee (Steering Committee) to guide the FSMP development process, starting from identifying the critical issues to finalizing the FSMP’s policy recommendations, before submitting the complete proposal to the Minister of Finance for approval (Figure 1). The Steering Committee was comprised of representatives from government sector, regulatory agencies, financial institutions, financial user groups, general public, and a number of recognized experts (Box 2). Using information and analysis provided by the Bank of Thailand’s working group and external consultants, the Steering Committee sifted through detailed background studies to produce outputs supportive of Thailand’s developmental needs.

Figure 1: Function of Steering Committee



### I. FORMULATING THE FSMP

The process of formulating the FSMP was divided into the following three stages. Throughout the entire process, the Steering Committee applied a mind mapping technique (replicated in Figure 2) to help extract and keep track of the overriding issues derived from the vast amounts of information presented for their consideration.



## **BOX 2 : FINANCIAL SECTOR MASTER PLAN COMMITTEE**

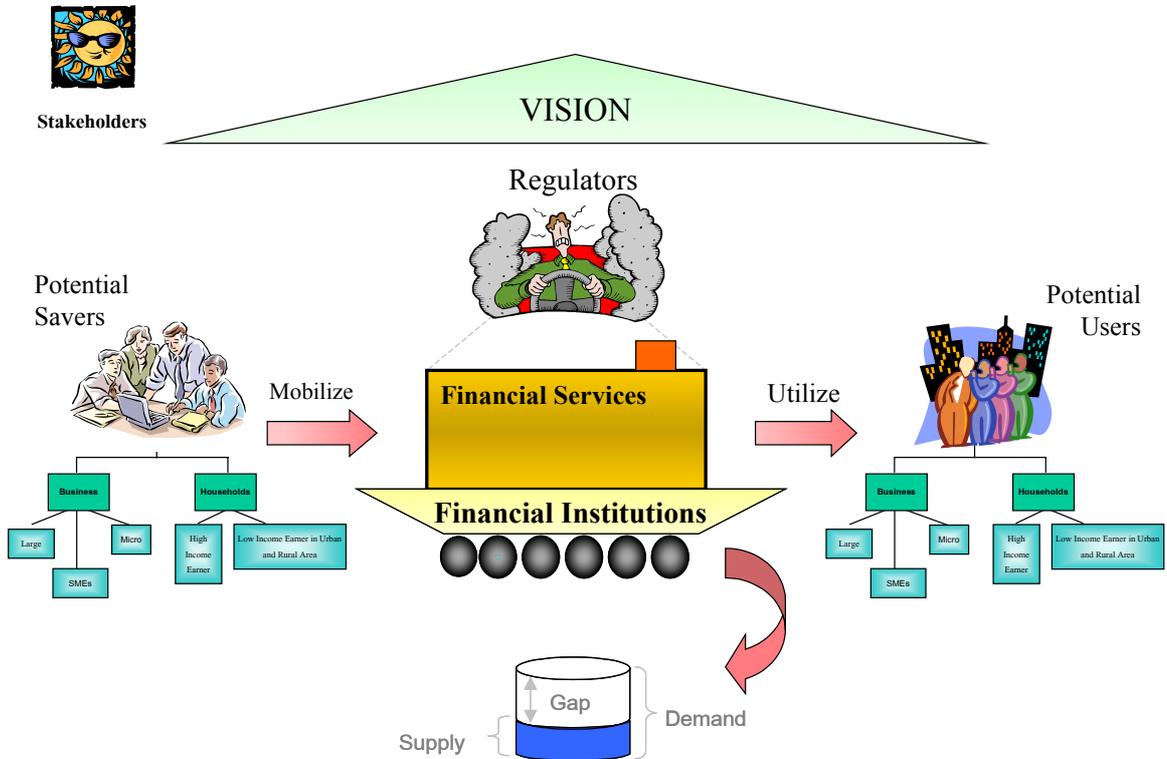
Under directive number 68/2002 dated February 21, 2002 the Bank of Thailand established the Financial Sector Master Plan Committee with the following roles and responsibilities:

- (1) Determine the objective(s) of Thailand's Financial Sector Master Plan and scope of work;
- (2) Determine procedural issues and oversee work of the Financial Sector Master Plan Drafting Committee;
- (3) Authorize the appointment of external advisors and experts to perform research studies that may be deemed useful for the development of the Financial Sector Master Plan;
- (4) Determine the overall policy direction and provide advise on how to further develop the financial sector, including ways in which to improve financial structure or other related structures; and,
- (5) Deliberate the Financial Sector Master Plan proposed by the Financial Sector Master Plan Drafting Committee.

### **Composition of Steering Committee**

- |  |                       |
|--|-----------------------|
| (1) M.R. Pridiyathorn Devakula, Governor   | Chairman              |
| (2) Mr. Thirachai Phuvanatanarubala, Deputy Governor (Financial Institutions Stability)                | Director              |
| (3) Mr. Pakorn Malakul Na Ayudhya, Deputy Governor (Monetary Stability)                                | Director              |
| (4) Mr. Prasarn Trairatvorakul, Secretary-General, Securities and Exchange Commissions                 | Director              |
| (5) Ms. Potjaneer Thanavaranit, Director General, Department of Insurance, Ministry of Commerce        | Director              |
| (6) Mr. Ammar Siamwala, Distinguished Scholar, Thailand Development Research Institute                 | Director              |
| (7) Mr. Chaiyawat Wibulswasdi, advisor to Minister of Finance  | Director              |
| (8) Mr. Kosit Panpiemras, Chairman, Bangkok Bank Plc.  | Director              |
| (9) Mr. Sataporn Jinachitra, Senior Executive Vice President, Siam Commercial Bank Plc.                | Director              |
| (10) Mr. Pakawat Kowitwattanapong, Managing Director, Trinity Wattana Co. Ltd                          | Director              |
| (11) Mr. Tawee Butsunorn, former Director and Chairman of the Executive Board, Thai Military Bank Plc. | Director              |
| (12) Mr. Suwan Traipol, former Manager, Bank for Agriculture and Agricultural Cooperatives             | Director              |
| (13) Mrs. Tarisa Watanagase, Assistant Governor, Financial Markets Operations Group                    | Secretariat           |
| (14) Mrs. Tasna Rajatabhothi, Assistant Governor, Financial Institutions Policy Group                  | Assistant Secretariat |

Figure 2: Mind Mapping Used to Guide Steering Committee Discussions



### Stage 1: Problem Identification and Hypotheses Setting (January – April 2002)

The Steering Committee held several meetings from February to April 2002 to consider fundamental problems of inadequate financial services for certain segments of the public. According to the 2001 World Competitiveness Report, Thailand ranked 44th from 49 countries in terms of credit flows from banks to businesses. This implied that Thailand had ample room left to enhance its financial competitiveness and improve the financial sector's intermediation capability and efficiency.

Moreover, internal studies showed that there were members of the public, particularly those in the rural area and low-income in both urban and rural area, which lacked access to basic mainstream banking services. It is believed that success in closing or lessening these gaps will help expand the financial sector's customer base, domestic savings, and lay the groundwork for stable long-term macroeconomic growth.

Financial reliance on commercial bank loans was another key topic addressed by the Steering Committee. Looking at composition of the private sector's external financing between 1988-1998, commercial banks in Thailand accounted for over 76 percent of all external funding compared to 21 in the US.<sup>1</sup> Although local corporations have begun to turn towards the capital market as an alternative source of funding,

<sup>1</sup> Monetary Policy Group, Bank of Thailand

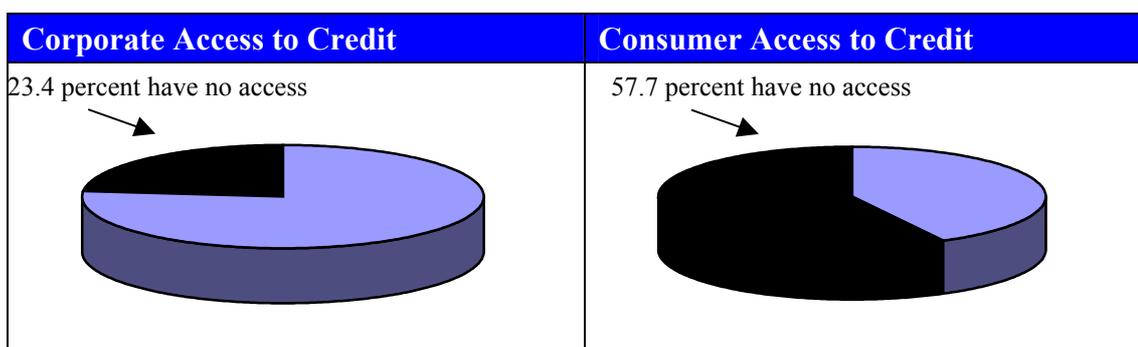
commercial banks remain dominant, making the economy particularly vulnerable to changes in the banking sector.

By its sixth meeting in April 2002, the Steering Committee was able to establish preliminary objectives and framework that became the basis for detailed analyses to be performed by the Bank of Thailand’s working group and international consultant in Stage 2.

**Stage 2: Hypothesis Verification (May 2002 – January 2003)**

The Steering Committee commissioned CSN & Associates Company Limited to perform a nationwide survey on household and business sectors’ perception and satisfaction with current financial services. The purpose of the survey was to confirm which urban and rural customer groups were insufficiently served by financial institutions and why.<sup>2</sup> (Summary of Household and Corporate Survey Results are in Appendix D and E)

The nationwide survey, which covered 4,800 individuals<sup>3</sup> and 1,190 corporations,<sup>4</sup> revealed that although both consumers and corporations were well served by the system in terms of deposits, it was access to credit that posed the most problems. The survey revealed that 57.7 percent of all consumers, mostly low-income with income less than 100,000 baht annually, do not have access to formal credit channels, while 23.4 percent of corporations surveyed, majority of which are small to medium size enterprises (SMEs), faced similar problems. The survey further revealed that both consumers and corporations felt that current financial service providers should improve the pricing of their financial products and services.



Beyond access to credit, the survey unexpectedly exposed a general public demand for better financial education. Up to 70 percent of consumers thought that they

<sup>2</sup> CSN & Associates held focus groups with low –income households in three provinces, middle to high income households in three other provinces, and in-depth interviews with 20 business owners before finalizing the list of survey questionnaire.

<sup>3</sup> Consumers surveyed were categorized by income level and place of domicile (urban and rural) throughout the country.

<sup>4</sup> Corporations surveyed were categorized by size based on the classification of the Ministry of Industry, place of establishment (urban and rural), types of business (industrial/manufacturing, export/import, and retail).

were not receiving sufficient information on product risks and stability of service providers, while respondents from every survey group believed that they were not receiving enough financial news and information.

Corresponding with the nationwide survey, the Bank of Thailand also engaged McKinsey & Company to benchmark the Thai financial system with international best practices to determine market-based development options most appropriate for Thailand's economic profile and modern sector needs. The report analyzed not only international trends, but also used focus groups to gather the opinions of financial experts from local and foreign financial institutions, rural banks, and capital market.

By forecasting the long-term outlook and needs of Thailand's real economic sector, the report came out with market-based prescriptions that addressed the root causes of financial service deficiencies such as dominance of bank lending, fragmented industry structure, and convoluted supervisory framework that undermined player performance. The resulting recommendations emphasized the need to reform the financial infrastructure specifically the rationalization of the roles and types of financial institutions and implementation of sustainable means to improve access to financial services for the urban and rural retail segment. At the same time, the report also advised on the need for improved consumer protection, credit information services, legal system, and capital market development.

### **Stage 3: Finalize Vision and Policy Recommendations (January – December 2003)**

Based on the above empirical analyses, the Steering Committee finalized three main visions for the Thai financial system, and further identified areas of improvement that would help authorities realize those visions. These areas were later subdivided into core and supporting reform measures. Once the Steering Committee finalized the strategies and action plans, the entire package was submitted to the Minister of Finance for approval.<sup>5</sup> Upon giving consent to the draft plan, the Minister of Finance then presented the plan to the Council of Ministers, which formally acknowledged the FSMP in December 2003.

## **II. FSMP VISIONS**

**Vision 1:** Provide financial services to all potential, economically viable, users whereby users should have access to basic financial products and services at the appropriate pricing.

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<sup>5</sup> For the purpose of ensuring effective cooperation between financial regulators, it is customary for representatives of relevant supervisory agencies to be present and involved during major policy deliberations. In terms of the FSMP, the advisor of the Minister of Finance (Mr. Chaityawat Wibulswasdi), Secretary General of Securities and Exchange Commission (Mr. Prasarn Trairatanavorakul), Director General of the Department of Insurance (Ms. Potjaneer Thanavaranit), were appointed as directors in the Steering Committee. This mixture of financial regulators was also repeated for the Committee to review application to establish commercial bank in accordance with the Financial Sector Master Plan, whose role will be discussed in further detail in Chapter 3.

**Vision 2:** Develop competitive, efficient, stable, and balanced financial system, capable of servicing the sophisticated and unsophisticated users; and,

**Vision 3:** Ensure fairness and protection for customers whereby financial institutions must abide by good corporate governance standard, and consumers receive adequate information and advice from various financial institutions to make informed investment decisions.

### III. POLICY RECOMMENDATIONS

Core Reform Measure	Supporting Reform Measures
<ul style="list-style-type: none"> <li>Rationalize structure of the financial system</li> </ul>	<ul style="list-style-type: none"> <li>Improve basic infrastructure of the financial system</li> <li>Improve competitiveness of individual financial institution</li> <li>Remove regulatory impediments to financial sector development</li> <li>Improve systemic efficiency through strengthening of market-based mechanisms</li> </ul>

#### **Core Reform Measures Rationalize Structure of the Financial System**

The core recommendation serves the fulfillment of Vision 1 and 2 since it entailed extensive wholesale reorientation of the financial system to better service both the underserved and modern sector.

#### Vision 1: Provide Financial Service to All Economically Viable Users

##### *Rural Low-income*

A. Creation of APEX institutions to provide support and improve operations of indigenous community savings and microfinance groups in the rural area. Unbeknownst to the general public, there already exist many organic savings groups in Thailand that came about in response to communities' unanswered financial needs. Yet although these groups are successful in providing basic lending and deposit services to members, their sustainability is uncertain due to inadequate management and liquidity support i.e. clear and established operational procedures, and access to low-cost sources of fund. Thus it was believed that the establishment of an umbrella APEX organization may be able to help indigenous financial groups continue provide much needed financial services to their community.

This assumption was bolstered by the fact that APEX organizations in other countries have proven to be successful in empowering community savings groups. Studies revealed that previous APEX organizations were able to remedy limitations of local savings groups by acting as the intermediary matching liquid savings and microfinance groups with illiquid ones; benchmarking member group's credit

worthiness thereby improving the groups' chance of accessing formal financial institutions; and, helping develop banking skills and operational procedures.

B. Build upon the success of the state-owned Bank for Agriculture and Agricultural Cooperatives (BAAC) by broadening its business scope beyond being a pure agricultural bank and towards becoming a rural development bank that provides credit and services to low-income rural consumers, village funds, and all types of cooperatives.

The survey found that low-income consumers with higher repayment ability than grass-root consumers can benefit from better access to established government-owned specialized financial institutions (SFIs) such as the BAAC. With more tailored financial products and flexible means in providing financial services to economically viable low-income consumers,<sup>6</sup> the BAAC can potentially build upon their achievements and at the same time earn profitable returns from servicing this customer group.

#### *Urban Low-income*

A. Establish market-based incentives for financial institutions to offer services, especially credit and advisory services, to low-income consumers. This recommendation centers on the development of new business models and tools that will allow state-own and private commercial banks to gainfully provide financial services to low-income segments.

South Africa's Standard Bank is an example of how a commercial bank can use technology to profitably provide financial services to urban low-income users.<sup>7</sup> Standard Bank is one of the top commercial banks in South Africa to provide financial services to the urban low-income segment through its affiliate called E-Bank.

E-Bank overcame the problem of high cost associated with servicing low-income<sup>8</sup> by employing innovative and low-cost delivery channels such as ATMs. E-Banks established approximately 100 user-friendly service centers conveniently located in shopping centers and main city thorough ways, which contained 2-4 ATMs and 2-3 staff members whose only tasks were to welcome and assist customers' ATM usage. Without any back office functions, E-Bank's transaction cost fell further by approximately 30-40 percent.

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<sup>6</sup> Survey results showed that consumers want the option to borrow small size loans with flexible repayment schedule, and the ability to borrow emergency loans.

<sup>7</sup> McAndrews, James and Paulson, Jo Ann "Financial Services for the Urban Poor: South Africa's E Plan," World Bank working paper, 1999 and Moore, David "Financial Services for Everyone," McKinsey Quarterly, 2002.

<sup>8</sup> Low-income users have small average account balance, yet would frequently visit commercial banks to perform minor transactions, thereby increasing cost burdens on the servicing commercial bank.

Other than convenience and speed, E-Bank financial products were also specifically tailored to low-income users. E-Bank offered a single depository account with card-based access with no checking privileges and passbooks. In practical terms, with only proof of income, identification, and US\$ 8, potential users could easily open a deposit account with life insurance with E-Bank.

As evidence of their success, while it takes about 8,000 transactions per month for commercial banks to break even on ATM machines, the average number of transactions for E-Bank in 1999 was roughly 12,000. After three years in operations, E-Bank had gained approximately 1.4 million E-Plan account holders.<sup>9</sup>

B. Provide new licenses to entrants interested in providing services to the underserved. In other words, create a new type of license that addresses specific problems or gaps in services within the system. Under this recommendation, authorities also envisioned providing regulatory incentives, such as lower risk weights for loans extended to the underserved, for financial institutions that cater to SMEs and/or retail consumers.

#### Vision 2: Develop Competitive, Efficient, Stable and Balanced Financial System

A. Restructure licensing regime to allow capable financial institutions (both domestic and foreign) with restricted licenses to broaden their scope of business by upgrading themselves to full license financial institutions. This recommendation aimed to lessen regulatory arbitrage caused by the existence of numerous types of licenses that instead of creating financial institutions with specific niches, produced ones that competed for the same customer group based on artificial differences in costs of funding and regulatory restrictions. This consequently created an un-leveled playing field whereby certain financial institutions were unfairly disadvantaged.

B. Relax regulatory limitations on foreign financial institutions so as to heighten competitive pressure that may encourage faster introduction of new financial instruments and innovation. This included allowing foreign bank branches the ability to become a subsidiary with the right to establish 4 additional branches.

C. Permit financial conglomerates to have only one type of deposit-taking financial institution within their group in order to prevent regulatory arbitrage, support industry consolidation and motivate financial institutions to better capitalize on their economy of scale. Before this proposal, financial conglomerates were allowed to have a commercial bank, finance company, and international banking facilities (IBFs) that were all taking in public deposits.

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<sup>9</sup> In an effort to reduce costs even further, E-Bank was merged with other consumer banking plans within Standard Bank in early 1996. E-Bank clients were transferred to an E-Plan and the E-Bank facilities were renamed Auto Bank-E Outlets.

## **Supporting Reform Measures**

The supporting reform measures are broad and designed to facilitate all three of the FSMP's visions. Yet, it is clearly the measure to improve basic financial infrastructure that deals directly with Vision 3 (fairness and protection for customers).

### Improve Basic Infrastructure of the Financial System<sup>10</sup>

The FSMP seeks to improve regulatory coordination, remove obstacles to asset management and debt restructuring via reforms of Bankruptcy and Foreclosure Laws, and enhance capability of credit bureau to provide adequate and reliable information to financial institutions. This measure includes endeavors to strengthen consumer protection mechanisms in order to provide consumers with the tools and information necessary for protecting their interests. Such mechanisms could include requirements for financial institutions to create customer complaint centers and publish financial instrument prospectuses in easy to understand formats.

### Improve Competitiveness of Individual Financial Institution

In line with the Bank of Thailand's move towards consolidated and risk-based supervision, the FSMP contains provisions for promoting internal risk-based management and good corporate governance practices among financial institutions. In addition the FSMP also proposes increasing operational flexibility among financial institutions by expanding the list of permitted activities and allowing financial institutions the ability to establish financial groups with the organizational structure of their own choosing, i.e. bank-parent or holding company structure.

### Remove Regulatory Impediments to Financial Sector Development

Any efforts to improve operational flexibility of financial institutions will naturally include plans to remove and alter regulatory impediments and red tape that placed unnecessary burdens on financial institutions. Such regulatory impediments may concern rules that require commercial bank branches to lend a certain proportion of their deposits within the geographic area around their branch location.

### Improve Systemic Efficiency by Strengthening Market-based Mechanisms

Other market-based recommendations involve the development of clear entry and exit policy for new financial service providers and capital market support. Revised entry policy would include procedures for new entrants and capable financial institutions to broaden their scope of business via license upgrades. Nevertheless, authorities realize that clear exit strategies for weak financial institutions must also be developed together with the new entry policy. Lastly, the strengthening of market-based mechanisms also includes the continued support for the development of the Thai capital market as a substitute source of funding.

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<sup>10</sup> The term basic infrastructure refers to such issues as laws and regulations, and credit information.



#### IV. FSMP IMPLEMENTATION STAGES

Authorities agreed that to ensure prudent implementation of the extensive list of proposals and allow for future review of the recommendations in light of empirical results the implementation of the FSMP should be done in staggered phases.



##### **Phase 1: 1-3 years**

In the initial implementation phase authorities will work to enhance operational efficiency and flexibility of existing players while beginning the far-reaching process of reorganizing the current structure of the financial sector. Also incorporated in Phase 1 will be measures to strengthen market-based mechanisms and remove regulatory barriers to efficiency.

##### **Phase 2: 4-6 years**

The crux of Phase 2 will entail the review and revisions of the FSMP via comparison of recommendations with empirical data gathered from Phase 1. Phase 2 will also focus on the potential entry of new players, and capital market development.

##### **Phase 3: 7-10 years**

The last phase of FSMP will involve another feasibility study of recommendations in light of empirical results.



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## CHAPTER 3: PROGRESS OF IMPLEMENTATION

*“Good governance is the corner stone of a stable financial sector. We must create a banking community that does not tolerate imprudent business practices and lax systems and control. These are the sins of the past.” Governor M.R. Pridiyathorn Devakula, February 2004*

The following Chapter will highlight the progress of Phase 1 implementation for each Vision that began immediately after the Council of Ministers acknowledged the FSMP in December 2003.

### I. VISION 1: BROADEN ACCESS TO FINANCIAL SERVICES

#### (1) Microfinance System Development Committee (Microfinance Committee)

The Microfinance System Development Committee (Microfinance Committee) was established by the Ministry of Finance in August 2003 for the purpose of promoting efficient and sustainable grass-root financial services. The Microfinance Committee is comprised of the Minister of Finance as chairman, Governor of the Bank of Thailand as director, as well as representatives from other related institutions including NGOs, savings groups, and government organizations. The Microfinance Committee later created a sub-committee comprised of public and private stakeholders to draft the Master Plan for Grass-Root Financial Services in view of strengthening the financial system in the grass-root level. The sub-committee has already completed its fieldwork research using information derived from public hearings in the north, northeast, and southern region, and is in the process of drafting the development plan.

#### (2) Creation of APEX Institution

As mentioned in Chapter 2, the FSMP proposed the creation of APEX institutions to perform functions that indigenous savings groups need and lacked. However, due to strong financial and political support from the government, the evolution and transformation of grass-root financial services has picked up speed in recent years. There are ongoing discussions to potentially allow capable village funds to either upgrade themselves or merge with other village funds to become village financial institution with expanded scopes of business (e.g. payment services) and customer base.<sup>1</sup>

Ironically, such government policies have led existing government microfinance umbrella organizations, such as GSB, BAAC, Krungthai Bank (KTB) and the Office of the National Village and Urban Community Fund Committee, to start taking up certain APEX functions previously identified by the FSMP. This

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<sup>1</sup> Village funds are allowed to provide financial services to village members, while potential village financial institution may be allowed to provide financial services to people in the larger sub-district level.



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progress is a welcomed development since the task of addressing existing weaknesses and promote self-sufficiency has correctly fallen to organizations with the most microfinance expertise and know-how. Potential future research studies on the roles and functions of these umbrella organizations may help find additional areas of support and harmonize functions and standards of umbrella organizations.

### **(3) Development of New Business Model**

Internal research and survey revealed that grass-root level consumers do not have much choice in either service providers<sup>2</sup> or financial services<sup>3</sup> and therefore dependent upon non-formal institutions (i.e., money lenders or loan sharks), which charge unreasonably high interest rate. Believing that a new business model can remedy this gap, the Bank of Thailand held a seminar on 'Financial Services for All: Business Models for the Underserved' in November 2003. The seminar was successful at publicizing the unique needs of grass-root consumers as well as pointing out the viability of applying new technology to service this customer group.

From the seminar and subsequent discussions with relevant stakeholders, it was found that the Office of the National Village and Urban Community Fund Committee<sup>4</sup> in conjunction with the Government Savings Bank (GSB) are in the process developing computer application software that will facilitate financial transactions between Village Funds/ microfinance groups and state-owned commercial banks.<sup>5</sup> The software's successful implementation would help prove that new technology can help generate reasonable returns from transactions between commercial service providers and low-income clients. Accordingly, the project's success may lead to the expansion of the software application to other underserved communities in the future.

### **(3) Risk-weight Amendments**

The Bank of Thailand assigned new risk weights<sup>6</sup> for assets related to retail customers and SMEs as a market incentive for commercial banks to service these customer segments.<sup>7</sup> The key difference between the old and new risk-weight is that

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<sup>2</sup> Current service providers in Thailand, particularly commercial banks, cannot fully serve the low-income customers since they still rely almost exclusively on traditional branch networks as both acquisition and service points, making it unprofitable for them to service grass-root consumer whose transactions are relatively less frequent and smaller in value than those of higher income level customers.

<sup>3</sup> Results of focus groups revealed that rural low-income consumers felt that the financial services provided by commercial banks are too inflexible and intimidating.

<sup>4</sup> A government organization under the supervision of the Office of the Prime Minister.

<sup>5</sup> Government Savings Bank (GSB), the Bank for Agriculture and Agricultural Cooperative (BAAC), and Krungthai Bank (KTB), all of which are leading service providers to Village Funds and microfinance groups.

<sup>6</sup> Risk weights are used to calculate financial institution's capital fund requirements.

<sup>7</sup> This new risk weights are compulsory for new loans, yet for existing loans commercial banks have a choice of using the old or new risk-weights.



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the new amendments allow commercial banks highly skilled in credit scoring, risk management and diversifying their credit portfolio to apply lower risk-weights to retail and consumer loans that fit the specified criteria.<sup>8</sup>

The underlying rationale concerns the fact that because retail loans consist of many different types of small loans, this broad characteristic allows for natural diversification with lower risk profile. Thus, the risk-weight amendment could help reduce capital fund requirement for commercial banks with expertise in retail and consumer loans.

## II. VISION 2: INCREASE EFFICIENCY OF FINANCIAL SECTOR

The recommendations under this vision are broken into two sections. The first concerns the streamlining of rules and regulations that may inhibit efficiency gains, while the second and most far-reaching part concerns the comprehensive reorganization of the financial institutions under the supervision of the Bank of Thailand.

### Section 1: Streamlining Rules and Regulations

The task of removing burdensome and obsolete policies is an ongoing task and a key part of the regulator's mission. As such, the list of policies below is far from being an exhaustive one.

A. Improve competitiveness of individual financial institutions and groups through developments in risk management, good corporate governance, flexibility in conducting financial business (business structure), as well as the use of alternative business models (IT outsourcing).

**Risk Management:** In preparation for the full implementation of the New Basle Capital Accord in 2008, the Bank of Thailand has sent three consultative papers on the New Basle Capital Accord for comments by financial institutions in 2005.<sup>9</sup> The Bank of Thailand has also issued a notification concerning the collection of loss data in August 2004 aimed at enhancing financial institutions' ability to monitor and manage operational risk.

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<sup>8</sup> For example, the new risk-weights assigned to fully collateralized credits extended for dwelling houses of natural persons – not exceeding three million baht and account for no more than 0.2 of the total amount of loans within the same category – is 35 percent down from 50 percent. Should the loan become nonperforming, the risk-weights would rise to 100 percent. Another example is for credit extended to SMEs in the amount not exceeding 50 million baht or no more than 0.2 of the total amount of loans within the same category, the risk-weights is 75 percent and 150 percent if it becomes nonperforming.

<sup>9</sup> The consultative papers concerned the application of the Standardized Approach for credit risk, Standardized and Basic Indicator Approach for operational risk, and the Internal Ratings Based approach. All were sent for comments by financial institutions in January, February and July 2005 respectively. FIs will have to submit application to the Bank of Thailand stating their preliminary intention to undertake the Standardize or Internal Ratings Based Approach together with their self-assessment of readiness by June 2006.



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**Good Corporate Governance:** The Bank of Thailand issued a notification in July 2004 that determined the fit and proper criteria for directors and senior management of financial institutions. This guideline was the same one used to vet the qualifications of directors and senior management within the applications for change of status submitted by financial institutions under the FSMP.

B. Resolve tax impediments to financial sector development. Mergers and transfers of assets that occurred under the FSMP have been exempted from tax liabilities, and authorities have also removed tax benefits for out-in transactions of International Banking Facilities (IBFs).

C. Improve basic infrastructure of the financial sector through development of credit bureau<sup>10</sup> and related laws, such as the Deposit Protection Act<sup>11</sup> and Financial Institutions Businesses Act.<sup>12</sup>

D. Remove regulations that impede financial sector efficiency. The Bank of Thailand has relaxed the rule requiring commercial banks wishing to open branches in well-served area to concomitantly open a branch in the rural areas. Furthermore, commercial banks operating the last commercial bank branch in a local community will be allowed to close that branch if they have a plan to offer substitutable financial services to that community.<sup>13</sup>

The Bank of Thailand has further relaxed social responsibility rule that require a Thai provincial commercial bank branch to provide credit or do business no less than a certain percentage of their deposit in the operating region and country respectively.<sup>14</sup> A similar amendment for foreign banks is also being deliberated.

E. Enhance market mechanism, through the establishment of clear exit-procedures. The Bank of Thailand is currently researching the supervisory regime of other countries to establish trigger points that will initiate orderly exit procedures for troubled financial institutions. Commercial banks will be invited to participate in the process of developing the trigger points so as to ensure agreeable and transparent exit procedures.

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<sup>10</sup> The Credit Bureau Act has already been enacted on March 2003, while current amendments to remedy certain operational limitations are undergoing the second reading by the lower house of Parliament.

<sup>11</sup> Currently, the draft DPA is under final consideration by the Office of the Council of State. Upon completion, the Office of the Council of State will forward the draft DPA to the Ministry of Finance who will submit it for approval by the Council of Ministers. Once endorsed by the Council of Ministers, the draft DPA will be tabled to Parliament in accordance with legal procedures.

<sup>12</sup> The Ministry of Finance is in the process of reviewing the draft Financial Institutions Businesses Act. The Act has already been included in the Ministry of Finance's legislative agenda.

<sup>13</sup> Before this amendment, a commercial bank operating the last branch in any community was not allowed to close that branch.

<sup>14</sup> Thai provincial commercial bank branch is required to invest or lend no less than 60 percent of the total amount of deposit within its operating region. Foreign bank branches are required to lend, or do business, no less than 70 percent of their local deposit and borrowing within Thailand.



F. Amend rules to assist capital market development. Because commercial banks are the biggest investors and market makers in the local capital market, the Bank of Thailand is considering amending rules and regulations to allow commercial banks a broader and more in-depth role in enlarging distribution channels and increasing liquidity of the capital market.

## **Section 2. Rationalizing Structure and Roles of Financial Institutions**

The FSMP aims to enhance efficiency and competition within the system by reforming the licensing regime to lessen regulatory arbitrage and overlapping scopes of business. This translated to the creation of only two types of deposit-taking institutions with one designed specifically for filling the gaps in services for low income and small cap companies. At the same time, the new regime will allow foreign players to have a bigger role in the Thai financial system by providing such players with the opportunity to establish presence in Thailand either as a branch or subsidiary.

### *(1) Restructure Commercial Bank Licensing Regime*

Henceforth, there will only be two types of financial institutions mobilizing public savings:

A. **Commercial banks** for qualified and well capitalized financial institutions. Such commercial banks may provide financial services to every group of customers and carry out virtually all types of financial transactions, except insurance underwriting and brokering, trading and underwriting of equity securities. The minimum capital requirement is currently placed at 5,000 million baht of tier-1 capital.

B. **Retail banks** for qualified financial institutions with much smaller capital requirement. Retail banks may offer basic financial services to every type of customers, with the limitation that they may only provide credit, or other similar transactions, to retail customers and SMEs. They may provide virtually all types of financial transactions with the same exceptions as commercial banks, and are not allowed to conduct business related to foreign exchange (unless permitted by the Minister of Finance), and derivatives products (unless for risk-hedging of own portfolios). The minimum capital requirement is 250 million baht of tier-1 capital.

There are several characteristics that make retail banks different from finance companies. Evidently the fact that retail banks will be allowed to accept public deposits and need not be restricted to raising funds via promissory notes like finance companies falls under this category. But more importantly, authorities have developed clear procedures and criteria for qualified retail banks to upgrade themselves to full commercial bank status without being constrained by their existing license. Under this situation, should a qualified retail bank decide to compete with commercial banks, they will be allowed to do so on a level playing field.

### *(2) Enhance Role of Foreign-owned Financial Institutions*



To enable foreign-owned financial institutions to play a greater role in the Thailand's economic and financial development, foreign-owned commercial banks will have the option of establishing presence under two types of foreign bank licenses instead of one:

A. **Full branch**, enjoying the same scope of business as Thai commercial banks but with only one branch. The foreign bank branch must maintain assets in Thailand in the amount no less than baht 3,000 million baht, in accordance with the types, procedures and conditions as prescribed by the Minister of Finance, from the day it begins its operation.

B. **Subsidiary**, enjoying the same scope of business as Thai commercial banks and are allowed to open four branches in addition to one head office – two branches in the Bangkok metropolitan area, and the remaining three outside the Bangkok metropolitan area. The subsidiary must have paid-up registered capital in the amount no less than 4,000 million baht from the day it begins operation.

This form of subsidiary establishment is a new concept for Thailand and is a direct response to pressures for further financial liberalization. Since the financial crisis taught Thailand about the downside of unencumbered liberalization, only qualified existing foreign bank branch and stand-alone international banking facilities were allowed to apply for a subsidiary license within the timeframe set by authorities in accordance with the FSMP (please see Box 3).

### *(3) Reduce Number of Deposit-taking Financial Institutions within the Same Conglomerate under “One-presence” Policy*

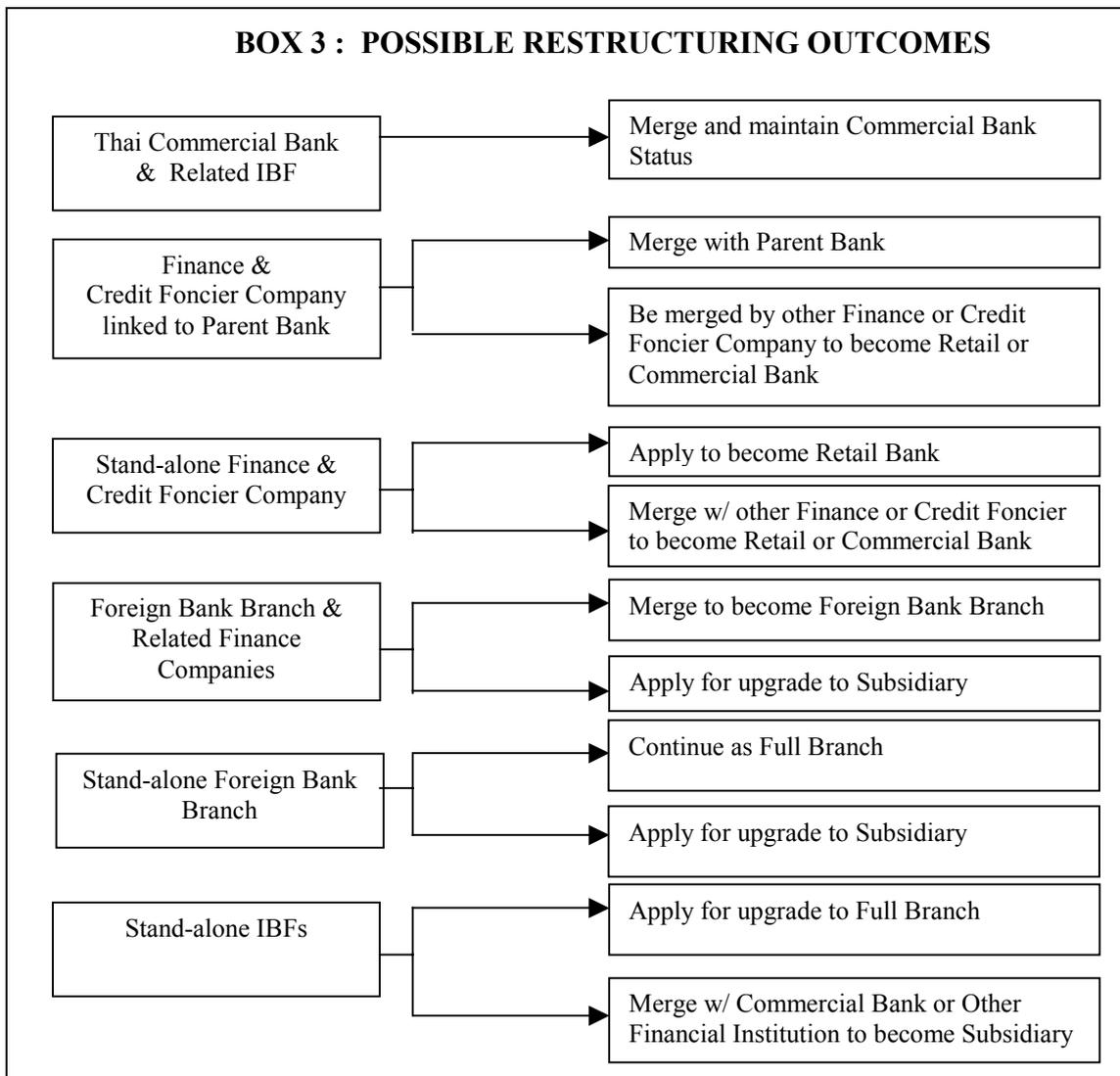
Currently financial conglomerates are allowed to maintain a number of deposit-taking financial institutions within their financial group – reflecting the artificial regulatory distinction between commercial banks, finance companies, and credit foncier companies. To reduce this unnecessary duplication, the new commercial bank licensing regime will remove cumbersome distinction in the scope of business, making it redundant to have different types of financial institutions within the same group. Indeed, to reap full benefits from economy of scale there need to be only one type of deposit-taking institution in a financial conglomerate.

## **Evaluation Criteria for Application for Change of Status Under Vision II**

The Ministry of Finance issued three notifications that set out the rules, procedures, and conditions for establishing commercial banks, retail banks, subsidiaries and full branches on January 30, 2004. Existing financial institutions that met the application qualifications outlined in the notifications were allowed to submit applications to change their status by July 30, 2004. As summarized in Box 3, the notifications determined that:



### BOX 3 : POSSIBLE RESTRUCTURING OUTCOMES



A. Thai and foreign finance or credit foncier company that are linked to a parent bank may either submit application to return their license and merge with the parent bank under the One-presence policy, or become a target for a merger by other finance or credit foncier company in order to become a retail or commercial bank. The respective finance and credit foncier company may also return their licenses to become a credit company.

B. Stand-alone Thai and foreign finance company and credit foncier company may either submit an application to change their status to a retail bank, or if so wish, apply for a full commercial bank license if they have a viable plan to merge with one other finance or credit foncier company. Similar to (A) above, stand-alone finance and credit foncier companies may also return their license and continue operating as a credit company.



C. Foreign bank branches and related finance companies may merge together under One-presence policy and retain their branch status, or apply for an upgrade to subsidiary status.

D. Stand-alone foreign bank branches may retain their branch status or submit an application seeking upgrade to subsidiary status.

E. Stand-alone IBFs may submit a plan to apply for full branch status or have a viable plan to merge with another finance or credit foncier company to become a subsidiary.

Notably, finance or credit foncier companies that did not apply for a commercial banking license could continue to function as finance or credit foncier companies, or as mentioned earlier, return their licenses and continue to operate as a credit company. However, since authorities have already expanded the business scope of commercial banks to include factoring, leasing and hire purchase businesses – traditionally disallowed for commercial banks – remaining finance and credit foncier companies will be facing heightened competition from commercial banks that have lower cost of funding.

### **Procedures for Approving Applications**

Interested financial institutions that wished to change their license based on the options allowed under the FSMP had to submit their applications to the Bank of Thailand by July 30, 2004. Once the applications were submitted, the Bank of Thailand had one month from the submission deadline to verify the completeness of the documents.

#### **BOX 4 : Composition of Committee to review application to establish a commercial bank in accordance with the Financial Sector Master Plan**

1. Governor of the Bank of Thailand – President
2. Director General, Fiscal Policy Office, Ministry of Finance
3. Secretary General, Securities and Exchange Commission
4. Director General, Department of Insurance, Ministry of Commerce
5. Deputy Governor, Financial Institutions Stability, Bank of Thailand
6. Deputy Governor, Monetary Stability, Bank of Thailand
7. Mr. Prasit Kovilaikool
- \* Mr. Krirk Vanikkul, Assistant Governor, Financial Institutions Policy Group, Bank of Thailand – Committee Secretary

After the applications were deemed complete, they were then forwarded to the Committee to review application to establish a commercial bank in accordance with the Financial Sector Master Plan (Committee), created by the Ministry of Finance and responsible for considering the application (composition of Committee in Box 4). The Committee had altogether three months to review the eligibility and suitability of applicants' business plans using criterion derived from international standards (Box



5), and submit their recommendation to the Minister of Finance, who had two months to issue the final decision.

### **BOX 5 : EVALUATION CRITERIA FOR APPLICATIONS**

The evaluation of financial institutions seeking new license contains two parts – Part I concerns the assessment of the financial institution’s eligibility to apply for commercial bank license, and Part II entails the assessment of the financial institution’s business plan upon receiving the commercial bank license in order to gauge the readiness of the financial institution to become a commercial bank.

#### *Part I. Assessment of the Financial Institution’s Eligibility*

Apart from the quantitative criteria such as BIS ratio, NPA, and provisioning, the eligibility of applicants further depends upon the evaluation of the following qualitative criteria.

##### Part 1: Compliance to Corporate Governance Guidelines

- Assess whether or not the behavior of financial institutions contradicts with corporate governance guidelines issued by the Bank of Thailand – performed together with evaluation of other corporate governance factors in Part 2.)
- Assess that there are no change of major shareholder(s).

##### Part 2: Evaluation of Management Quality

- Role of board of directors, shareholders, and senior management starting from level of director.
- Behavior of directors and senior management starting from level of director
- Risk management
- High risk business operations
- Organizational structure
- Internal control and audit
- Compliance with important regulations
- Compliance and cooperation with official policy

#### *Part II. Assessment of the Financial Institution’s Business Plan*

##### Part 1: Fit and Proper of Management and Shareholders

- Directors and management
- Shareholder structure

##### Part 2: Assessment of Business Plan

- Business plan
- Organizational structure and management
- Business continuity plan

Following the Minister of Finance’s approval, successful applicants must comply with all conditions determined by the authorities, such as:

A. Complete process of merger/acquisition with other financial institutions in compliance with all requirements prior to requesting for the license from the Minister of Finance. Commercial banks, retail banks, and subsidiaries must begin operations



within one year after the Minister of Finance's approval, except under necessary circumstances, the Bank of Thailand may grant a waiver but not more than six months. On the other hand, full branches must begin operations within six months from the date of the Minister of Finance's approval.

B. Business groups that have more than one type of deposit-taking financial institutions with no IBFs must comply with the One-presence policy within a year from the date of the Minister of Finance's approval.

C. Commercial banks or full branches with IBFs must receive transfers of assets and liabilities into the commercial banks or full branches and return the IBFs licenses within 6 months after both the Minister of Finance has approved the plans and the law to revoke IBFs tax benefits is effective.

D. Business groups with more than one form of deposit-taking financial institutions, as well as IBFs, must return the IBFs licenses within 6 months after both the Minister of Finance has approved the plan and the law to revoke IBFs tax benefits is effective. The rest of the process must be completed within one year from the date of the Minister of Finance's approval

### Summary of Submitted Plans

By December 31, 2004 the Committee successfully reviewed a total of 40 applications and forwarded their final recommendation to the Minister of Finance for approval. Of the 40 submitted plans:

TABLE 2: SUMMARY OF SUBMITTED PLANS					
Number of Applications for Each License				One-presence	
Commercial Bank	Retail Bank	Full Branch	Subsidiary	IBF Only	IBF & Others
4	7	2	1	19	7
				Total	40

### Summary of Minister of Finance Approval

As of first half of 2005, the Minister of Finance has approved all One-presence and change of license applications described in Table 3.

TABLE 3: MINISTER OF FINANCE DELIBERATION RESULTS		
Name of Financial Institutions	Types of License	Approval
<b>Thai Financial Institutions</b>		
1. TISCO Finance PCL merge with Thai Permsap Finance Co. Ltd.	Commercial Bank	✓
2. Kiatnakin Finance PCL merge with	Commercial Bank	✓



**TABLE 3: MINISTER OF FINANCE DELIBERATION RESULTS**

Radhanatun Finance PCL		
3. Asia Credit PCL merge with Bualuang Finance Co. Ltd.	Commercial Bank	✓
4. Thai Keha Credit Foncier Co. Ltd.	Retail Bank	✓
5. Land and Houses Credit Foncier Co. Ltd. Merge with Book Club Finance PCL	Retail Bank	✓
<b>Foreign Financial Institutions</b>		
6. GE Money Finance PCL	Retail Bank	✓
7. AIG Finance (Thailand) PCL	Retail Bank	✓
8. Societe Generale International Banking Facility	Full Branch	✓
9. UFJ Bank Ltd.	Full Branch	✓
10. The International Commercial Bank of China	Subsidiary	✓

As a result of the rationalization program, the number of financial institutions under the supervision of the Bank of Thailand fell almost by half from 83 in December 31, 2003 (before FSMP) to 40 as summarized by Box 6. This is the second time since 1997 that the numbers of financial institutions declined dramatically.<sup>15</sup>

The success of this process would not have been possible without the cooperation and assistance provided by the financial institutions. The end result is proof that strong collaboration between public and from private sector is vital to the development and sustainability of Thailand's key financial system. In all, it is always easier to achieve a communal goal if participants agree on the needed path.

### **III. VISION 3: MEASURES TO IMPROVE CONSUMER PROTECTION**

#### **(1) Customer Complaint Procedures**

The Bank of Thailand has continuously supported customer protection policy through encouraging financial institutions to maintain clear procedures for handling customer complaints. This also includes the promotion of transparent information disclosure in line with international standard.

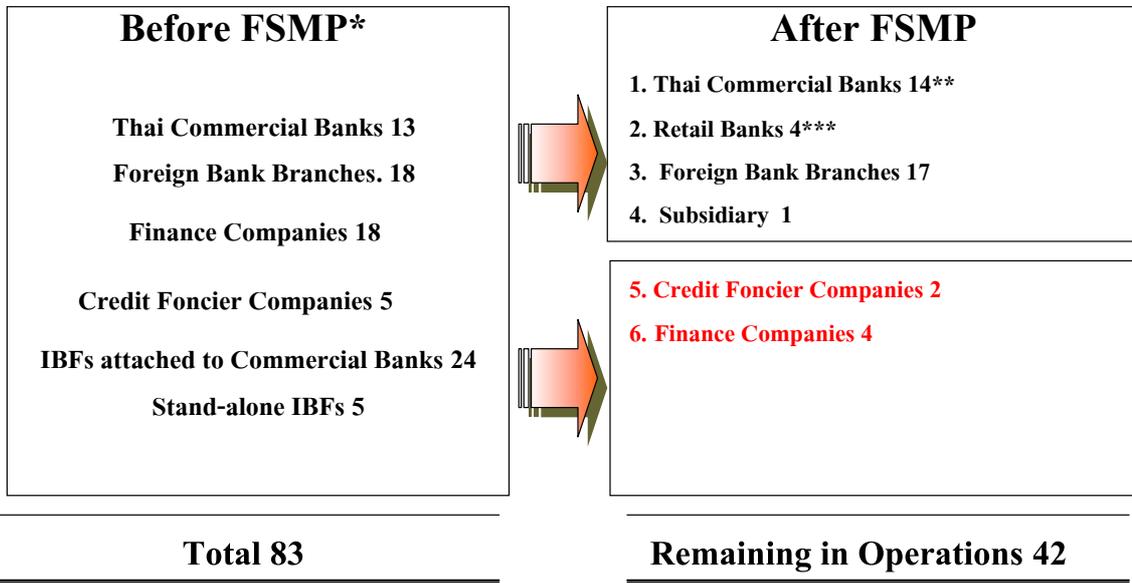
#### **(2) Retail Deposit Protection**

The government announced the abolishment of its guarantee for creditors of financial institutions since November 16, 2003. This was done to support the development of long-term domestic financial market and in line with the phasing out

<sup>15</sup> As shown in Chapter 1, the number of financial institutions, excluding International Banking Facilities (IBFs) attached to commercial banks, fell from 154 to 59.



### BOX 6 : FINANCIAL LANDSCAPE POST-FSMP



\* December 31, 2003

\*\* Including merger between UOB Radanasin Bank PCL. and Bank of Asia PCL.

\*\*\* Two retail bank applicants are still under deliberations.

of the blanket guarantee. In place of the blanket guarantee will be the Deposit Insurance Agency (DIA) Act that will cap the level of government guarantee to no greater than 1 million baht per individual depositor account per bank. Although the level of protection has decreased, the scheme still covers around 98.6 percent of the total number of retail deposit accounts in Thailand, but with the added benefit of curtailing moral hazard and strengthening market discipline.

Currently, the draft DPA is under final consideration by the Office of the Council of State. Upon completion, the Office of the Council of State will forward the draft DPA to the Ministry of Finance who will submit it for approval by the Council of Ministers. Once endorsed by the Council of Ministers, the draft DPA will be tabled to Parliament in accordance with legal procedures.

### (3) Interest Rates and Fees Calculation

In response to recommendations made by prominent economists and comments from the nationwide survey, the Bank of Thailand issued a notification on August 4, 2005 that established uniform standard for commercial banks to publish their deposit interest rate, effective interest rate for commercial and consumer loans, together with the fees and expenses associate with credit extensions.<sup>16</sup>

<sup>16</sup> To ensure transparency and cooperation, the standard was developed in close cooperation with the industry.



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The benefit of this notification is the fact that with uniform calculation standard, consumers will be able to perform price comparison across different financial institutions. To make things even more convenient, the Bank of Thailand is in the process of developing ways to publicize the deposit and lending interest rates of each commercial bank on the Bank of Thailand's website. In the near future, the Bank of Thailand hopes to expand this concept to cover material fees charged by commercial banks.

#### **IV. GOING FORWARD**

Authorities recognize that because financial institutions are in the process of adapting their strategies and positioning to the new supervisory regime and competition outlook, the initiation and details of Phase 2 policies must reflect environmental realities in addition to empirical results and impact analysis of Phase 1 reforms.

Detailed research studies presented at the annual Bank of Thailand's Symposium in August 2005 highlighted several macroeconomic challenges that will need to be addressed by all stakeholders especially those in the financial sector. These include the decline in household savings levels and changes in the macroeconomic structure and financial system infrastructure. The latter two are significant to the financial sector since both require financial institutions to adapt and maintain strategic vigilance to ensure smooth transition.

The macroeconomic challenges for financial institutions involve the interest rate up-cycle and potential adverse consequences from the unwinding of global imbalances that may exacerbate existing foreign exchange mismatches among SMEs. At the same time, financial institutions are presented with new business opportunities arising from large-scale government infrastructure projects and demographic changes namely the increase in number of people entering family age and hence the expansion of potential borrower base.

Financial landscape adjustments on the other hand naturally encompass the heightened competition from the FSMP, capital market, and non-bank financial intermediaries, and also prudential evolutions from the introduction of Deposit Insurance Act, Basel II Capital Accord in International Accounting Standard 39. Because derivatives trading in Thailand is still minimal relative to more developed markets, the implementation of Basel II with its refined sensitivity to key risks faced by deposit-taking financial institutions, and Deposit Insurance Act will pose dramatic impact on the Thai financial system. Thus in this era of supervisory and industry reform, domestic and foreign deposit-taking financial institutions will need to find competitive niches either domestically and regionally while at the same time managing risk exposures using more sophisticated tools.

The past and present has shown that the global financial landscape is one characterized by rapid change and dangerous pitfalls. Authorities therefore have to be progressive and flexible enough to adapt the supervisory regime to new developments pertinent to Thailand. As such, the final details of the FSMP's subsequent phase will



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depend on the competition and gap analyses similar to that performed during the development of the FSMP.<sup>17</sup>

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<sup>17</sup> As was mentioned in Chapter 2, Phase 2 may potentially entail entrants of new players and the implementation of policies conducive to capital market development.

## **APPENDIX A**

### **LIST OF ACRONYMS**

BAAC	Bank for Agriculture and Agricultural Cooperatives
BOT	Bank of Thailand
Committee	Committee to review application to establish commercial bank in accordance with the Financial Sector Master Plan
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
FIPB	Financial Institutions Policy Board
FIPG	Financial Institutions Policy Group
FSMP	Financial Sector Master Plan
Microfinance Committee	Microfinance System Development Committee
GSB	Government Savings Bank
IBF	International Banking Facility
KTB	Krungthai Bank Public Company Limited
MOF	Ministry of Finance
NESDB	National Economic and Social Development Board
SET	Stock Exchange of Thailand
SFIs	Specialized Financial Institutions
SMEs	Small to Medium Size Enterprises
Steering Committee	Financial Sector Master Plan Committee

## APPENDIX B

### **Opening Remarks of Governor M.R. Pridiyathorn Devakula “Commercial Banking and Financial Service: Our Vision for Thailand”**

**Conference on “Modernizing Our Financial System: Challenges for the  
New Millennium” at Hotel Plaza Athenee, Bangkok  
January 23<sup>rd</sup>, 2002**

**Your Excellencies**

**Distinguished Guests**

**Ladies and Gentlemen,**

I would like to take this opportunity to welcome all of you to our conference on *"Modernizing our Financial System: Challenges for the new Millennium"*. I would also like to express our deep appreciation for the distinguished speakers who came all the way from Australia, Canada, Hong Kong, and South Africa to share with us their expertise and knowledge on this very important topic. And, of course, to the World Bank, our co-host, for help organizing the conference.

Our financial crisis in 1997 and its subsequent impacts highlighted the lesson of critical importance that dynamic and strong domestic financial institutions are vital to sustainability of development and growth. Over the past 20 years, financial sector has been one of the major forces that support our progress and financial services share in our GDP has grown from a mere 3 percent to roughly 8 percent. It is the fifth largest industry in term of value added to our GDP, and currently employing more than 300,000 of our workforce. Nevertheless, despite such favorable development, there are some concerns:

- First, in term of competitiveness of our financial institutions, there is room for improvement. The International Institute for Management Development in its well-known *World Competitiveness Report* ranked our competitiveness position in finance for the year 2001, 44th from the top 49 countries in the world.

- Second, in term of financial service availabilities, there are still some people lacking adequate access to the mainstream banking activities, particularly those in the rural area and those with low-income in the urban area. Recent statistic reveals that 54 districts in Thailand have neither branches of commercial banks nor those of specialized financial institutions.

- Third, there are inherent weaknesses within our system. We are overly dependent on commercial banks as the main channel of financial intermediaries with bank loans accounting for 70 percent of external funding in Thailand, comparing to 20 percent in the US. Although large corporate and the Royal Thai government have recently turned to capital market as their alternative sources of financing, bank loans remains dominant, making the economy particularly vulnerable to changes in commercial banking sector.

These are the issues that we will be focusing on today. And following this conference, the Bank of Thailand will embark on the process to articulate our medium-term plan to increase competitiveness of financial institutions, improve people access to financial services, ensure financial system sustainability, and take this opportunity to systematically correct problems which remain unresolved by financial reform implemented thus far.

### **Ladies and Gentlemen**

Our financial institutions must be the sources of our national strength and should be the main instrument in our development. In the past five years, significant and comprehensive reform of our commercial banking system has been achieved, with financial stability being restored; corporate governance, strengthened; competition within domestic banking system enhanced with the entrance of new competitors. At the same time, new financial services such as E-banking and other innovative instruments such as smart cards are on the offer to customers giving them more choices of financial services with greater qualities.

We are therefore at this point ready to move forward to the next step – to articulate our vision for the future of commercial banking and financial services in Thailand, taking into consideration powerful forces from the rapidly globalized international financial markets and the emerging financial landscapes within the region.

### **Ladies and Gentlemen**

The new financial sector master plan must be realistic and address the fundamental problems that we have. I see no role for the plan to strive to be a financial center or to develop the financial sector for its own sake.

Thailand has a dual economic structure, with the modern industrial sector overlaying with the more traditional sectors outside Bangkok which employed more than half of our population. Thus, we should concentrate on improving the efficiency and stability of our domestic financial institutions to best serve our real sector. And our vision for Thai commercial banking and financial services – if it is to be useful – must consist of two parts within a single integrated framework: one for our main banking activities and the other for those in rural areas.

As we look at cross-country experiences on commercial banking and financial system inquiries, we were drawn toward the experiences of Australia, Canada, and South African. The South African's Standard Bank has been quite innovative in using new technologies to reduce cost of providing banking services to the urban poor who were formerly thought of as un-bankable. Similarly, the Canadian Financial Services Taskforce put much emphasis on “ensuring highest standard of quality and services to consumers, regardless of their income, and regardless of where they live; urban or rural, and also to individual businesses, whether they are large or small”.

On the other hand, the emphasis of the Australian Financial System Inquiry on “the facilitation of financial conglomerates to realize economies of scale and scope as

well as streamlined regulatory structure base on functional not institutional distinction” will become more and more relevant in the future as consolidation and diversification within our financial system lead to similar types of business model.

Coming up with a broad vision is comparatively a simple task; the real challenge is to work out the details of how we plan to modernize of our financial system. Here, we have to articulate our vision and implementation strategies together from both practitioners’ and regulators’ point of view. We have to:

1. identify potential unfulfilled need for financial services in the medium term so that we can adequately accommodate needs of our consumers and corporate in the real sector. These include financing of small and medium-sized enterprises as well as long-term financing.
2. determine problems, obstacles, and bottlenecks within our financial infrastructures as well as tax issues that will constraint us from achieving our full potential;
3. revisit the existing specified scopes of businesses for each types of financial institutions and determine appropriate structures for our financial conglomerates, taking into consideration the increasingly blurring of traditional lines that have previously separated commercial banking, investment banking, and insurance businesses from one another;
4. prioritize our aims and construct appropriate benchmarks to set clear targets of development and measure our performance;
5. and, of course, re-examine the current regulatory structure once the market reform is already underway.

### **Ladies and Gentlemen**

You may ask how you can be involved?

In the next nine months, our staff will conduct background studies, commission additional research papers, and take inputs from relevant stakeholders through market interviews and focus groups. We invite you to actively participate in our public consultation process and encourage you to take initiatives by making public submission on topics which you feel are critical for the development of our desired financial system.

Though most of our work and recommendations will focus on financial institutions under the supervision of the Bank of Thailand, we expect that the outcome of this process will provide a common framework for policy-making among the supervisory authorities in Thailand and serve as a shared foundation for coordinating

our efforts between the private and public sectors in transforming our financial infrastructures towards a deeper, more efficient, balanced and sound system.

As we move forward, this plan together with the new Financial Institutions Act currently under consideration by the Joint Committee of the Senate and the Lower House, the Deposit Insurance Act, and the supervisory standard as will be specified in the New Basel Accord, will provide a future framework within which our financial institutions will operate.

I would like to close by saying that our future is in our hand. We ask for your cooperation in positioning our financial system for the future. I am fully confident that together we can contribute to the benefits of our nation.

Thank you.

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## APPENDIX C

### Lessons Learned from Conference on “Modernizing our Financial System: Challenges for the New Millennium,” January 23<sup>rd</sup>, 2002

#### 1. Process of Developing Financial Sector Master Plan

##### 1.1 Lessons Learned from the Australian and Canadian Experience

- Speed of implementation is important. Long time lag between formulation and implementation may lead to higher costs and difficulty.
- Vision and objective of the Financial Sector Master Plan has to be clear.
- Implementation actions should be flexible.
- Emphasize transparency.
- Staff the project with the right people, give them the ample room to do their job, and support them accordingly.
- Support from existing regulator agency is vital.

##### 1.2 Means of Enhancing Public Participation the Canadian Task Force

- Allow public submission though the Task Force’s website.
- Establish private and public meetings between the Task Force and public.
- Hold focus groups and interviews.
- Post discussion papers on Task Force website and invite public scrutiny and comments.

#### 2. Implications of Change for Asia

- Since commercial banks are providers of wholesale and retail financial services, disintermediation will result in commercial banks performing less capital-intensive services.
- Risk management and trading portfolios will become increasingly important for both balance sheet and profit generation.
- Differentiation of financial services will be based more on service and quality, and not scale.
- Technological developments will allow for the unbundling of financial services.

### **3. Key Successes for Microfinance**

- Clear understanding of customers' needs and behavior.
- Use technology to lower costs.
- Price services according to risk and operating costs.

### **4. Information Derived from Panel Discussions**

4.1 Social Responsibility: Can social responsibilities be performed on a commercial perspective? Or should regulators play an intervening role?

The definition of social responsibility varied among the panelists. But the overall consensus from the panelists is that the regulator's role is not to legislate policies that force financial institutions to perform social functions such as extending credit to a particular segment of society. If the government is to intervene in a commercially unprofitable endeavor, then there should be an implicit understanding that some institutions will have to bear the cost borne out of that endeavor. Another option is to legislate less intrusive policies that use market incentives to motivate financial institutions such as removal of interest rate ceiling, use of moral suasion, risk sharing through credit guarantee program, or make the requirement a conditions attached to the license.

4.2 Foreign Participation: How much more can/should we liberalize our financial system?

There were two approaches to this issue of foreign participation. First approach states that should be no limits placed on foreign ownership, while the second and more cautious approach espouses optimal limits. There is no argument that foreign competition will motivate domestic financial institutions to enhance their efficiency while also providing technological know-how. On the other hands, depending on each country's preferences and readiness, certain limits may be placed on foreign participation in order to ensure survival of domestic financial institutions. Nevertheless, the commitment of domestic financial institutions to the market helps crate employment, ensure long-term economic development, and recapitalization during times of market failure.

## APPENDIX D

### EXCERPTS OF HOUSEHOLD SURVEY RESULTS (2002)<sup>1</sup>

#### Category of Households Surveyed

	<b>Low-Income</b>	<b>Middle-Income</b>	<b>High-Income</b>	<b>Very High-Income</b>
<b>Income Level</b> <i>(Thai baht)</i>	Less than 100,000/year	100,000-200,000/year	More than 200,000/year	More than 500,000/year

Note: Urban denotes area within sanitary district (similar to a municipality), while rural denotes area outside the sanitary district.

#### 1. Response to Household Financial Services Needs

##### 1.1 Current Unmet Financial Service Needs of Households

Most respondents felt that emergency loans, and loans with low payment installments and life insurance were important to daily life. But only a small group of respondents (less than 50 percent) have adequate access to such services. This was particularly true for low-income households because they: cannot meet borrower's qualifications, were insufficiently informed, received complicated conditions attached to loans, and did not have enough collateral.

- Low-income Urban and Rural: Both groups felt that emergency loans, loans with low payment installments, loans for daily living expenses, and life insurance were important financial products for daily life. But less than 50 percent of low-income urban respondents received such financial services, while less than 50 percent of low-income rural respondents have access to only emergency loans and life insurance.
- Middle-income Urban: Financial products that middle-income urban respondents felt were important, but less than 50 percent have access to, were similar to those mentioned by low-income respondents. However, differ from low-income respondents, middle-income urban respondents also wanted better access to collateral-free loans for small business owners.
- Middle-income Rural: Financial products that middle-income rural respondents felt were important, but less than 50 percent have access to, are collateral-free loans for business owners, collateral-free loans for business expansions, and educational loans.

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<sup>1</sup> Consumers surveyed were categorized by income level and place of domicile (urban and rural) throughout the country. The statements herein were the opinions of CSN & Associates Company Limited and not those of the Bank of Thailand.

- Middle-income respondents felt that financial service provider's decisions to grant business loans should be based more on objective for loan use and borrower's ability to repay, instead of collateral value since most borrowers cannot find sufficient collateral.
- High-income Urban: Financial products that high-income urban respondents felt were important, but less than 50 percent have access to, were emergency loans and collateral-free loans for business owners.
- High-income Rural: Financial products that high-income rural respondents felt were important, but less than 50 percent have access to, were collateral-free loans for business owners. In addition, financial products that high-income rural respondents felt were important, but less than 80 percent have access to were emergency loans, loans with low payment installments, and life insurance.
- High-income households felt that small loans for emergency use may be necessary since it can be used as working capital to maintain liquidity. Therefore these respondents felt that financial service providers should base their decision to grant such loans on the objective of loan use and business viability, instead of collateral value. Financial service providers should also consider providing flexible conditions such as low initial payment installments.
- Very high-income Urban: Financial products that very high-income urban respondents felt were important, but less than 50 percent have access to, were emergency loans, working capital loans, or collateral-free business loans.
- Very high-income Rural: Financial products that very high-income urban respondents felt were important, but less than 50 percent have access to were collateral-free loans for business expansion. In addition, financial products that very high-income rural respondents felt were important, but less than 80 percent have access to were emergency loans, loans with low payment installments, and life insurance.
- Other types of financial services that households have limited access to, but not seen as having a high priority were bonds, funds with principle investment protection, equity/mutual funds, educational loans, installment loans, retirement funds, financial management and occupational advisory services.

## 1.2 Financial Services Currently Being Used and Will Remain Needed in the Future

In terms of deposits and investments, most respondents (87.5 percent) used a deposit account. Approximately 15-30 percent invest in funds, personal savings

groups, and special lottery accounts at state-owned commercial banks,<sup>2</sup> while less than 6 percent invest in bonds, financial securities, and promissory notes. The reasons for the lack of interest in the latter were low demand, household's financial profile does not accommodate such investments, and/or inadequate information on the services and products.

As for credit, the survey revealed that the majority of respondents applied for loans for working capital and business investment purposes (21 and 11 percent respectively). Almost every household group, except for the high-income and very high-income urban households, used working capital loans. Housing loans were the most prolific among high-income and very high-income urban households. The reasons for lack of household access to other types of credit were lack of demand for such services, complex loan conditions, lack of information on where to purchase the service, and uncompetitive pricing.

For fund transfers/Payment the majority of households in almost every survey groups, except the very high-income urban households that tend to rely more on credit cards than money orders, used ATMs (49.7 percent), make funds transfers through counters/tellers (36.5 percent), and buy money orders (30.9 percent). The reasons that majority of households did not have access to these services were lack of demand for such services, complex service conditions, lack of information on where to purchase the service, and expensive service fees.

Furthermore, approximately 34.9 and 25.4 percent of respondents have life insurance and non-life insurance respectively. Reasons for not using insurance services were lack of demand for these services, complex service conditions, and lack of confidence in the service.

As for future financial service needs:

- Low-income Urban: In terms of deposits, respondents wanted more access to special lottery accounts at state-owned commercial banks. For credit, respondents wanted more access to housing loans. Lastly, for fund transfers/payment and risk management, respondents wanted better access to direct debit and life insurance.
- Low-income Rural: In terms of deposits, respondents wanted more access to special lottery accounts at state-owned commercial banks. For credit, respondents wanted more access to business investment loans. Lastly, for fund transfers/payment and risk management, respondents wanted better access to ATMs and life insurance.

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<sup>2</sup> The Government Savings Bank (GSB) and Bank for Agriculture and Agricultural Cooperatives (BAAC) hold special lottery drawing where lucky low-income depositors have the chance to win certain prizes.

- Middle-income Urban: In terms of deposits, respondents wanted more access to special lottery accounts at state-owned commercial banks. For credit, respondents wanted more access to housing loans. Lastly, for fund transfers/payment and risk management, respondents wanted better access to credit cards, direct debit, checking services, and life insurance.
- Middle-income Rural: Wanted the same thing as middle-income urban respondents, except that in terms of credit, middle-income rural respondents wanted more access to educational loans.
- High-income Urban: In terms of deposits, respondents wanted more access to special lottery accounts at state-owned commercial banks. For credit, respondents wanted more access to business investment loans. Lastly, for fund transfers/payment and risk management, respondents wanted better access to telephone/internet fund transfers, direct debit, and life insurance.
- High-income Rural: In terms of deposits, respondents wanted more access to special lottery accounts at state-owned commercial banks. For credit, respondents wanted more access to housing loans. Lastly, for fund transfers/payment and risk management, respondents wanted better access to direct debit, visa electron cards, and non-life insurance.
- Very high-income Urban: In terms of deposits, respondents wanted more access to special lottery accounts at state-owned commercial banks and bonds. For credit, respondents wanted more access to business investment loans. Lastly, for fund transfers/payment and risk management, respondents wanted better access to telephone/internet fund transfers, credit cards, and life insurance.
- Very high-income Rural: Wanted the same thing as their urban counterpart in terms of deposits and loans. Yet, for fund transfers/payment and risk management, very high-income rural respondents wanted better access to telephone fund transfers, checking services, and non-life insurance.
- Respondents in each group wanted ability to save beyond just deposit accounts, such as special lottery accounts at state-owned commercial banks or bonds. Although other savings and investment options were available, the lack of understanding of those products was an obstacle to increase usage.
- Respondents wanted more ease and convenience in fund transfers/payment services from such services as direct debit, ATMs, and telephone/internet fund transfers. Nevertheless, the survey found that respondents still do not have confidence in the service and was also unsure about how to use the service.

## **2. Appropriate Scopes of Business for Thai Financial Institutions**

- Respondents in each group expected to receive financial services from (in descending order of importance) Thai commercial banks, specialized financial

institutions (SFIs), and insurance companies. This was because consumers were most acquainted with these financial service providers – they play the biggest role in servicing current financial service needs.

- Nevertheless, Thai commercial banks cannot provide services (particularly credit) to every consumer group due to restrictive loan conditions and lack of qualification of potential borrowers. The study found that SFIs have the opportunity to absorb those un-serviced needs, especially in providing credit with flexible conditions. Respondents did want to use SFIs in the same manner that they used commercial banks, but rather SFIs will need to improve their IT system and transaction speed if they were to compete with private commercial banks.
- Respondents' lack of information and understanding of other potential financial service providers – finance/credit foncier companies, cooperatives, and insurance companies – were obstacles preventing increase usage of those financial service providers.
- The study showed that low to middle-income respondents also used other financial service providers such as cooperatives or village funds (either self-established or created by the government). These financial service providers were conveniently located in the community and have a better understanding of the needs of the locals. Yet these service providers may lack good management skills or necessary sources of funds.
- Commercial banks do have opportunities to expand the type of services provided to consumers such as acting as insurance agent (some have already started to offer this service). Commercial banks have several advantages over other financial service providers in terms of consumer confidence, efficient service delivery, and broad customer base.

### **3. Improve Efficiency and Competitive Ability of Financial System and Thai Financial Institutions**

#### **3.1 Financial Services**

- Respondents gave high priority to pricing in terms of interest rate and fees (especially for deposits). Most were unsatisfied with current pricing. Respondents from every group felt that financial service providers, particularly commercial banks, charged inappropriate interest rates and fees.
- In terms of credit, respondents from almost every group felt that the lending rate was set at inappropriate levels and that the procedures for requesting credit was very inconvenient. (Middle-income rural and very high-income rural and urban respondents were unhappy with current services.) Because many in the public needed access to emergency loans, delays in providing such loans lead people to use the services of non-banks that charge very high interest rates.

### 3.2 Financial Service Providers

- Respondents expected financial service providers to be stable and capable of providing good quality services. This includes having experience and friendly staff, convenient service locations, fair pricing, and wide variety of services.
- Majority of respondents were least dissatisfied with the lack of service variety provided by current financial service providers, relative to other issues.
- Most respondents were satisfied with deposit, transfers/payment, and other services provided by commercial banks. However, low-income urban and rural respondents and high-income rural respondents were most satisfied with loan services provided by SFIs. While majority of respondents were happy with risk management services provided by insurance companies.

### 3.3 Delivery Channels

- Respondents still rely mostly on branches, followed by ATMs and sub-branches respectively. Telephone and internet banking were still not widely used.
- Respondents in each group stated that they may increase their ATM usage if given the opportunity. Yet, people were reluctant to replace their branch visits with telephone/internet banking because they either do not know how to use the service, have no confidence in its accuracy, or uncomfortable with lack of documentation as proof of their completed transactions.

### 3.4 Competitive Ability of Thai Financial Institutions and Entry of Foreign Financial Institutions

- Respondent with household income of more than 150,000 baht/year preferred to use Thai financial institutions as their main financial service provider. The underlying reason was because they fear foreign dominance, lay offs as technology replaces human beings, and lack of flexibility during negotiations. But respondents felt that entry of foreign financial institutions will help increase speed of services, and motivate Thai financial institutions to improve and modernize their services.
- Most respondents did want to try using services of foreign financial institutions if they believe that it was good and appropriately priced. Yet they would still employ the services of Thai financial institutions.

## **4. Consumer Education and Protection**

### 4.1 Financial Services

- Most respondents knew and understood basic financial services such as deposits, various types of loans, ATM card usage, money orders, fund transfers at tellers, and life and non-life insurance. Yet they still lacked

understanding of more complex financial services such as bonds, financial securities, promissory notes, telephone/internet fund transfers, and financial advisory services.

- Most respondents felt that commercial bank deposits were the least risky relative to other types of savings, followed by special lottery accounts at state-owned banks and deposits at cooperatives. Many respondents did not understand risk related to promissory notes, equity/mutual funds, and bonds.

#### 4.2 Financial Service Providers

Respondents in each group felt that SFIs were the most stable financial service providers (especially for deposits), followed by commercial banks and cooperatives respectively.

- Majority of respondents felt that SFIs have the least chance of collapsing, followed by commercial banks and cooperatives. The respondents were split in their assessment of risk associated with insurance companies, while more than half of the respondents did not know if credit foncier and finance companies could collapse or not.
- Respondents felt that deposits made at SFIs were the safest, since the government guarantees them, followed by commercial banks and cooperatives. More than 40 percent of the respondents did not know if the government protects deposits made at finance/credit foncier companies, insurance companies, and community savings groups.

#### 4.3 Receipt of News and Information

- Almost 70 percent of respondents, from every survey group, felt that they were not receiving enough financial news and information on financial products.

#### 4.4 Obstacles and Problem Resolution

- Up to 90 percent of respondents felt that they did not have problems with financial services from current financial service providers. Some of the problems mentioned are listed below.

##### 4.4.1 Problems With Deposits and Investments

- Problems with Thai commercial banks and SFIs: inconvenient length of transaction time, unequal treatment, low interest rate, complex service conditions, and inconvenient office locations.
- Problems with cooperatives: inconvenient length of transaction time, and lack of confidence in terms of management.

##### 4.4.2 Problems With Credit

- Problems with Thai commercial banks and SFIs: complex service conditions, inconvenient length of transaction time, high interest rates, too much emphasis on collateral and not enough consideration given to borrower's ability to repay, requirement that borrowers have stable income, and unequal treatment.
- Problems with village funds: complex service conditions, unequal treatment, too short loan maturities, too much emphasis on collateral and not enough consideration given to borrower's ability to repay, and high interest rates.

#### 4.4.3 Problems with Fund Transfers/Payment

- Problems with Thai commercial banks: inconvenient length of transaction time, insufficient number of office locations, high fee levels, complex service conditions, damage or loss, and unequal treatment.
- Problems with SFIs: inconvenient length of transaction time, insufficient number of office locations, complex service conditions, and unequal treatment.
- Problems with post office: inconvenient length of transaction time, insufficient number of office locations, high fee levels, complex service conditions, damage or loss, and lack of confidence in management.

#### 4.4.4 Problems with Risk Management

- Problems with Thai commercial banks: inconvenient length of transaction time, insufficient number of office locations, unequal treatment, low return, and inexperienced staff.
- Problems with SFIs: inconvenient length of transaction time, insufficient number of office locations, complex service conditions, unequal treatment, and lack of confidence in terms of management.
- Problems with insurance companies: inconvenient length of transaction time, complex service conditions, low return, unequal treatment, inexperienced staff, insufficient number of office locations, and lack of confidence in terms of management.

## APPENDIX E

### EXCERPTS OF CORPORATE SURVEY RESULTS (2002)<sup>1</sup>

#### Category of Corporate Surveyed

	Number of Employees			Total Fixed Assets ( <i>million baht</i> )		
	Small	Medium	Large	Small	Medium	Large
<b>Manufacturing</b>	<50	50-200	>200	<50	50-200	>200
<b>Services</b>	<50	50-200	>200	<50	50-200	>200
<b>Export/Import</b>	<25	25-50	>50	<50	50-100	>100
<b>Retail</b>	<15	15-30	>30	<30	30-60	>50

Note: (1) The lower of the two criteria determines the classification of the corporation.

(2) Urban denotes area within sanitary district (similar to a municipality), while rural denotes area outside the sanitary district.

#### 1. Response to Corporate Financial Services Needs

##### 1.1 Financial Service Needs of Corporations and Responses to those Needs

- Primary financial services that were important and greatly needed by corporations: deposit accounts at commercial banks, checking services for payment, short-term loans to be used as working capital, long-term loans for investment or business expansion, and guarantee credit from commercial banks.
- Other financial services needed by corporations: telephone/internet fund transfers and payment, employee's provident fund, business advisory services, risk management (interest rate and exchange rate), ability to invest excess funds, occupational training, raising funds from capital market, and raising funds through issuance of debentures.
- In terms of market response to corporate financial needs, the survey revealed that there was a link between needs and supply. The level of response depended on the level of importance for each type of financial service needs. In other words, the more important the financial service, the better the response. This shows that availability of financial services depended upon market forces. Nevertheless, small businesses' financial needs were least fulfilled relative to those of big corporations for almost all types of financial services.

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<sup>1</sup> Corporations surveyed were categorized by size based on the classification of the Ministry of Industry, place of establishment (urban and rural), types of business (industrial/manufacturing, export/import, and retail). The statements herein were the opinions of CSN & Associates Company Limited and not those of the Bank of Thailand.

- Among the different types of financial services needed and important to businesses, credit needs were the least fulfilled. The reasons for this were: complex lending rules and conditions, inadequate assistance/advice from financial service provider, and that financial service users can neither meet borrower's qualifications nor had adequate collateral. This was especially true for small businesses.
- Small-sized Urban: The types of financial services that were being moderately to highly fulfilled were deposit accounts at commercial bank, checking services for payment, and telephone/internet funds transfer and payment. Yet, their demand for short-term loans, to be used as working capital, and long-term loans for investment or business expansion were least fulfilled.
- Small-sized Rural: The types of financial services that were being fulfilled were deposit accounts at commercial bank, and checking services for payment. But contrary to their urban peers, their needs for short-term loans to be used as working capital, and long-term loans for investment or business expansion were already being moderately to highly fulfilled.
- Medium-sized Urban and Rural: The types of financial services that were being moderately to highly fulfilled were deposit accounts at commercial bank, checking services for payment, short-term loans to be used as working capital, guaranteed credit from financial institutions, and long-term loans for investment or business expansion. On the other hand, medium-sized rural business needs for telephone/internet funds transfer and payment were least fulfilled.
- Large-sized Urban and Rural: Similar to medium-sized businesses, the types of financial services that were being moderately to highly fulfilled were deposit accounts at commercial bank, checking services for payment, short-term loans to be used as working capital, guaranteed credit from financial institutions, and long-term loans for investment or business expansion.

## 1.2 Financial Services Currently Being Used and Will Remain Needed in the Future

The survey revealed that the financial services already being used by businesses were basic financial services that will remain needed in the future. The level of need consummately declines for occasionally used financial services. However, there was an agreement that there will be growing future demand for more convenient and cheaper channels of delivery such as telephone/internet funds transfer and payment.

Summary of future financial service needs:

- Deposits/Investment: Compared to other services, deposit services were the most important financial service for businesses today and in the future. There was a moderately increasing future need for other products such as bonds,

promissory notes, debt and equity instruments, derivatives, unit trust in various funds, and chit funds.

- **Credit/Fund Raising:** Short-term loans to be used as working capital, long-term loans for investment or business expansion, and guaranteed credit were necessary financial services for businesses today and in the future, especially for small-sized businesses. However, contrary to small-sized businesses, large-sized businesses had moderately increasing future demand for raising funds through the issuance of common equity, preferred shares, warrants, debentures, and finding strategic partner.
- **Fund Transfers/Payment:** Checking services for payment were necessary financial services for businesses today and in the future. There was an upward trend for other services such as telephone/internet fund transfers and payment, Letter of Credit/Trust Receipt, and BAHTNET/Media Clearing. (13.5 and 16.1 percent of corporate respondents wanted more future access to telephone /internet funds transfers and payment respectively.)
- **Risk Management:** Majority of respondents used non-life insurance, while large-sized businesses used other risk management products such as swaps, options, and forwards more than small-sized businesses. Nevertheless, future demand for non-life insurance and risk management tools were not very high.
- **Other Types of Financial Services:** Employee provident funds, foreign exchange services, trustee/custodian services, business advisory services, and fund management were services that although were moderately used today will be in more demand in the future, especially employee provident funds.
- **Small-sized Urban:**
  - **Deposits/Investment:** Had moderately increasing needs similar to the overall trends.
  - **Credit/Fund Raising:** Had increasing future need for all types of financial services
  - **Fund Transfers/Payment/Risk Management:** Had lower future need than rural peers for all types of financial services under this heading, but had increasing future need for BAHTNET/Media Clearing.
  - **Other Financial Services:** Both urban and rural small-sized businesses had relatively the same increasing future needs for services under this heading, except small-sized urban businesses had greater future demand for employee provident funds.
- **Small-sized Rural:**
  - **Deposits/Investment:** Had moderately increasing needs similar to the overall trends, except that they had declining future needs for bonds.

- Credit/Fund Raising: (a) Had increasing future need for short-term loans to be used as working capital and guaranteed credit for AVAL. (b) No increasing future demand for long-term credit for investment and business expansion, fund raising through issuance of common equity, preferred shares, warrants, or finding strategic partner (venture capital). (c) Declining future needs for raising funds via issuance of debentures.
- Fund Transfers/Payment/Risk Management: Had higher future need for all types of financial services under this heading relative to the urban peers, except for BAHTNET/Media Clearing, where small-sized urban businesses had greater future demand.
- Other Financial Services: Both urban and rural small-sized businesses had relatively the same increasing future needs for services under this heading, except small-sized rural businesses had lower future need for employee provident funds compare to their urban peers.
- Medium-sized Urban:
  - Deposits/Investment: Had moderately increasing needs similar to the overall trends.
  - Credit/Fund Raising: Had moderately increasing future needs for short and long-term loans, guaranteed credit, AVAL notes, and fund raising through issuance of common equity, preferred shares, warrants. Differ from their rural peers, had increasing future need for issuance of debentures and finding strategic partner (venture capital).
  - Fund Transfers/Payment/Risk Management: Had lower future need than their urban peers particularly for telephone/internet funds transfer and payment, including BAHTNET/Media Clearing, and other risk management tools.
  - Other Financial Services: Had moderately increasing future needs for other financial services.
- Medium-sized Rural:
  - Deposits/Investment: Had moderately increasing needs similar to the overall trends. Yet, maintained quite high future needs for promissory notes and bonds, and declining future needs for unit trusts in various funds.
  - Credit/Fund Raising: Had moderately increasing future needs for short and long-term loans, guaranteed credit, AVAL notes, and fund raising through issuance of common equity, preferred shares, warrants.

- Fund Transfers/Payment/Risk Management: Had higher future need than their urban peers particularly for telephone/internet funds transfer and payment, including BAHTNET/Media Clearing, and other risk management tools.
- Other Financial Services: Had same needs as urban peers, except lack increasing future needs for foreign exchange and trustee/custodian services.
- Large-sized Urban:
  - Deposits/Investment: Had moderately increasing needs similar to the overall trends.
  - Credit/Fund Raising: Had moderately increasing future needs for financial services under this heading.
  - Fund Transfers/Payment/Risk Management: (a) Had lower future need for telephone/internet funds transfer and payment relative to rural peers. (b) Had increasing future demand for letter of credit/trust receipt. (c) Declining future need for checking services used for payment
  - Other Financial Services: Had lower future need for other financial services than rural peers except for trustee/custodian services.
- Large-sized Rural:
  - Deposits/Investment: Had moderately increasing needs similar to the overall trends. But contrary to their urban peers, had no increasing future needs for promissory notes, chit funds, and unit trust in various funds.
  - Credit/Fund Raising: Same level of future demand as urban peers, except had declining future demands for long-term loans.
  - Fund Transfers/Payment/Risk Management: (a) Had higher future need for telephone/internet funds transfer and payment than urban peers. (b) No increasing future demand for letter of credit/trust receipt. (c) Declining future need for checking services for payment same as urban peers. (d) Had declining future needs for non-life insurance.
  - Other Financial Services: Had higher future need for other financial services than urban peers, but no increasing demand for trustee/custodian services.

## **2. Appropriate Scopes of Business for Various Types of Financial Institutions**

- Corporate respondents expect Thai commercial banks to be the main financial service provider for every type of financial services. This was because Thai commercial banks had stable image and the most widespread coverage, making it convenient and less time-consuming. Moreover businesses were more acquainted with Thai commercial banks than other types of financial institutions.
- Specialized financial institutions (SFIs) and hybrid commercial banks were ranked second and third respectively after Thai commercial banks. SFIs were seen as being better than other financial institutions (foreign bank branch, hybrid finance/credit foncier, securities company, mutual funds, international banking facilities, insurance company etc.) especially for business advisory services.
- There was not much variety in terms of financial services and financial service providers needed by small to medium-sized businesses in the rural area compared to those needed by their urban peers. Almost every small to medium-sized businesses in the rural area mentioned that they wanted to use Thai commercial banks. A very small minority of medium-sized rural businesses mentioned that they wanted to apply for long-term loans for investment or business expansion from BIBF.
- Large-sized businesses in the rural area mentioned that besides using Thai commercial banks, they would also like to apply for short and long-term loans, guaranteed credit, and interest rate and exchange rate risk management tools from foreign bank branches. Contrary to this, large-sized businesses in urban area had very little demand for foreign bank branches.
- Majority of the businesses used mainly Thai commercial banks for various types of financial services, except for risk management products where insurance companies were the primary financial service provider.
- Small-sized urban and rural businesses used mainly Thai commercial banks, except for risk management products where insurance companies were the primary financial service provider. However, small-sized urban businesses clearly had more variety of financial service providers to choose from compared to their rural peers. Small-sized rural businesses tend to use SFIs more than their urban peers.
- Medium-sized urban and rural businesses used mainly Thai commercial banks, except for risk management products where insurance companies were the primary financial service provider. Yet, medium-sized rural businesses used SFIs the most followed by insurance companies.
- Large-sized urban and rural businesses used mainly Thai commercial banks, except for risk management products where insurance companies were the primary financial service provider. However, large-sized urban businesses clearly had more variety of financial service providers to choose from

compared to their rural peers. Large-sized rural businesses tended to use SFIs more than their urban peers especially for risk management, deposits/investments, fund transfers/payment, and other financial services.

- Although Thai commercial banks were the main financial service provider for businesses, the level of usage of Thai commercial banks for deposits /investment, fund transfers/payment, and other financial services declined the larger the corporation becomes. This was because large-sized businesses tended to have more choice of financial service provider.
- Almost half the number of corporate respondents accepted that local financial service providers were interchangeable with one another. But a relatively large proportion of respondents stated that they were unsure if they would substitute financial service providers.
- Generally small-sized urban businesses were more willing to substitute financial service providers than their rural peers. However, in terms of purchasing equity through finance company or commercial banks, small-sized rural businesses were more willing to substitute financial service providers than their urban peers.
- Medium-sized urban businesses were more willing to substitute financial service providers than their rural peers. However, both medium-sized urban and rural businesses were relatively the same in their willingness to substitute financial service providers for services related to purchasing equity through finance company or commercial banks, trading unit trust via cooperatives and SFIs, purchasing financial services and products from finance companies, and buying insurance policy from insurance companies.
- Large-sized urban businesses were more willing to substitute financial service providers than their rural peers. However, large-sized rural businesses were more willing to substitute financial service providers than their urban peers for services related to purchasing insurance policy from insurance companies, cooperatives or finance companies, purchasing equity through finance company or commercial banks, and purchasing financial services and products from finance companies.
- The survey revealed that among businesses of different sizes, the level of willingness to substitute financial service providers did not vary much for the following services: bond purchase via cooperatives and SFIs; purchase of life and non-life insurance policies through cooperatives or finance companies; and, purchase of financial services from SFIs (same services that could be provided by commercial banks).
- In terms of funds transfer/payment via postal services, large-sized businesses were more willing to substitute financial service providers than small and medium-sized businesses.

- Contrary to the previous statement, small-sized businesses were more willing to substitute financial service providers than large-sized businesses for the following services: purchasing equity through finance companies or commercial banks; trading unit trust via cooperatives or SFIs; and, purchasing financial services and products from finance companies (same services that could be provided by commercial banks).

### **3. Improve Efficiency and Competitive Ability of Financial System and Thai Financial Institutions**

#### 3.1 Financial Services

- Deposits/Investment: Weaknesses that needed to be remedied immediately were the low interest rate level and rate of return. Secondary issues that should be addressed when opportunity arises were the provision of clear information and advice, and length of transaction time.
- Credit/Fund Raising: Weaknesses that needed to be remedied immediately were the high interest rate level, long length of time it takes to approve loans, and inconvenience in applying for loans. Secondary issue that should be addressed when opportunity arises was increase flexibility in loan repayment terms.
- Funds Transfer/Payment: Weakness that needed to be remedied immediately was the high fee level. Secondary issue that should be addressed when opportunity arises was increase range of services.
- Risk Management: Weakness that needed to be remedied immediately was the high fee level. Secondary issue that should be addressed when opportunity arises was improve capability of risk management advisory services.
- Other Financial Services: Weaknesses that needed to be remedied immediately was the high fee level and inconvenience and slow speed of services. Secondary issue that should be addressed when opportunity arises was capability of advisory services.
- Deposits/Investment: Businesses of every size in urban and rural area all mentioned that the weaknesses related to deposit (low interest rate and return) needed to be remedied immediately.
- Credit/Fund Raising:
  - Every business respondents, excluding small-sized rural businesses, wanted weaknesses related to high interest rate level and long length of time it takes to approve loans to be remedied immediately.

- Medium-sized urban and large-sized businesses in urban and rural area wanted weaknesses related to inconvenience in applying for loans to be remedied immediately.
- Medium-sized rural businesses wanted weaknesses related to flexibility in loan repayment terms to be remedied immediately.
- Funds Transfer/Payment: Businesses of every size in urban and rural area, except small-sized rural businesses, wanted weakness related to high fee level to be remedied immediately. Moreover, large-sized rural businesses wanted weaknesses related to inconvenience and long length of transaction time to be addressed immediately.
- Risk Management: Businesses of every size in urban and rural area, except small-sized rural businesses, wanted weakness related to high fee level to be remedied immediately. Medium-sized rural businesses felt that the high fee level can be remedied when opportunity permits, because they wanted weaknesses related to financial service provider's accountability to customers to be remedied immediately.
- Other Financial Services: Businesses of every size in urban and rural area, except small and large-sized rural businesses, wanted weakness related to high fee level to be remedied immediately.
  - Small-sized urban businesses wanted weaknesses related to capability of advisory services to be addressed immediately.
  - Medium-sized urban businesses wanted weaknesses related to inconvenience and long length of transaction time to be addressed immediately.
  - Medium-sized rural businesses also wanted weaknesses related to financial service provider's accountability to customers, reputation and expertise to be remedied immediately.
  - Large-sized rural businesses wanted weaknesses related to capability of advisory services, not high fee levels, to be remedied immediately.

### 3.2 Financial Service Providers

- Three main characteristics of financial service providers that were important to corporate financial users were stability, quality of service, and fair pricing for interest rates/fees.
- From the survey of service users' satisfaction with current services, stability and quality of service were considered as strengths of service providers while pricing was seen as a weakness that needs to be remedied.

- For middle and large-sized businesses in the rural area, quality of service was also seen as a weakness.
- Corporate respondents felt that Thai commercial banks provided the best service in every aspect, except in terms of risk management where insurance companies were seen as the best service providers.
- Small-sized Businesses:
  - Small-sized urban and rural businesses were most satisfied with the services provided by Thai commercial banks, except in terms of risk management where insurance companies were seen as the best service providers.
  - Small-sized urban businesses felt that Thai commercial banks come in second to insurance companies in terms of risk management services, while small-sized rural businesses felt that SFIs ranked second to insurance companies in this category.
  - For deposits/investment, credit/fund raising, funds transfer/payment, and other financial services: Some small-sized urban businesses ranked hybrid commercial banks second behind Thai commercial banks, while others ranked them third. Small-sized rural businesses were also most satisfied with Thai commercial banks followed by SFIs, except for other financial services where they ranked IBFs in second place.
- Medium-sized Businesses
  - Medium-sized urban and rural businesses were most satisfied with services provided by Thai commercial banks, except in terms of risk management where insurance companies were seen as the best service providers.
  - Medium-sized urban businesses ranked foreign bank branches and hybrid commercial banks second or third for deposits/investment, credit/fund raising and funds transfer/payment.
  - On the contrary, medium-sized rural businesses ranked hybrid commercial banks second for deposits/investment and SFIs second for other financial services.
  - In terms of funds transfer/payment, middle-sized businesses were only satisfied with Thai commercial banks.
  - For other financial services, medium-sized urban businesses ranked mutual fund companies second after Thai commercial banks, while medium-sized rural businesses ranked SFIs and mutual fund companies second and third respectively.

- Large-sized Businesses
  - Large-sized urban and rural businesses were most satisfied with the services provided by Thai commercial banks, except in terms of risk management where insurance companies were seen as the best service providers.
  - Large-sized urban businesses ranked foreign bank branches and hybrid commercial banks second and third respectively for deposits/investment, credit/fund raising, and funds transfer/payment.
  - Large-sized rural businesses ranked SFIs second for deposits/investment, third for credit/fund raising (same ranking as hybrid commercial banks), and third for funds transfer/payment (same ranking as foreign bank branches).
  - For other financial services, large-sized urban businesses ranked finance/credit foncier companies and mutual funds/insurance companies second and third after Thai commercial banks, while large-sized rural businesses ranked foreign bank branches and insurance companies second and third respectively.

### 3.3 Delivery Channels

This section asked about the frequency in usage of four types of delivery channels namely, branch office, sub-branch in department stores, telephone and internet banking.

- Bank branches were the most frequently used delivery channels. Large-sized businesses were the most frequent users of bank branches followed by medium and small-sized businesses respectively. At the same time urban businesses were more frequent users than rural businesses.
- Businesses, particularly those in the rural area, rarely used sub-branches. Business respondents that had used sub-branches mentioned that they do so very infrequently.
- Majority of businesses did not use telephone banking. It was clear that rural businesses were less frequent users of telephone banking than urban businesses. Yet large and medium-sized urban businesses that do use telephone banking mentioned that they use it every day or almost every day.
- Majority of businesses did not use internet banking. It was clear that middle and large-sized rural businesses were less frequent users than urban businesses. Yet businesses that did use internet banking mentioned that they use it every day or almost every day. Large and medium-sized businesses were more frequent users than small-sized businesses.

- Survey revealed that businesses preferred to use bank branches to other types of delivery channels. However, businesses were interested in using telephone (36 percent) and internet banking (44.5 percent) given its convenience, speed and low cost. Obstacle preventing increase usage of these channels were desire to deal directly with bank officers, low confidence in its accuracy, or lack of documentation as proof of their completed transactions

### 3.4 Competitiveness of Thai Financial Institutions and Entry of Foreign Financial Institutions

- Most businesses (67.8 percent) preferred to use Thai financial institutions as their main financial service provider.
- Businesses of every size in urban and rural area felt that Thai commercial banks provide better services than foreign banks in every aspect of financial services except risk management where large-sized urban businesses felt that foreign banks had the advantage.
- Businesses of every size in urban and rural area believed that entry of foreign financial institutions will help modernize Thai financial institutions, particularly in improving their operating system, speed and convenience of services, and the introduction of new financial services for businesses.
- Businesses of every size in urban and rural area believed that entry of foreign financial institutions may had adverse consequences namely, lack of commitment to Thailand by foreign financial institutions, increase number of layoffs after employing new technology, exacerbate financial problems in Thai commercial banks, and inflexible attitude (relative to Thai people) especially toward financial service users that had certain limitations.
- However, if a large reputable foreign financial institution entered the market and provided good quality services that were reasonably priced, then businesses may try using the services of that foreign financial institution while still employing Thai commercial banks. Medium and large-sized urban businesses were more willing to try using the services of foreign financial institutions than small-sized businesses.

## 4. Consumer Education and Protection

### 4.1 Financial Services

- Deposits/Investment: Business respondents knew and understood deposits the most (99.4 percent), followed by chit funds (79.9 percent), bonds (76.4 percent), unit trust in various funds (58 percent), promissory notes (56.6 percent), and debt/equity securities and derivatives (48.8 percent).
  - Businesses of every size in urban and rural area understood deposits and chit funds.

- Small-sized businesses had less financial understanding than medium and large-sized businesses.
- Medium and large-sized urban businesses had more financial understanding about promissory notes, unit trust in various funds, and other securities than rural peers.
- Credit/Fund Raising: Business respondents knew and understood long-term loans for investment and business expansion the most (91.7 percent), followed by short-term loans to be used as working capital (90.5 percent), guaranteed credit and AVAL notes (63.6), fund raising through issuance of debentures (56.6 percent), finding strategic partner (56.2 percent), and fund raising via issuance of common equity, preferred shares and warrants (53.2 percent).
  - Businesses of every size in urban and rural area understood short and long-term loans.
  - Small-sized businesses had significantly less financial understanding than medium and large-sized businesses.
  - Medium and large-sized urban businesses had more financial understanding about credit/fund raising services than their rural peers, especially in terms of finding strategic partner and fund raising via issuance of common equity, preferred shares and warrants.
- Funds Transfer/Payment: Business respondents knew and understood checking services for payment (99.2 percent), followed by telephone funds transfer/payment (80.3 percent), internet funds transfer/payment (70.8 percent), credit line for letter of credit/trust receipt (62.8 percent), and usage of BAHTNET/Media Clearing (45.5 percent).
  - Businesses of every size in urban and rural area had a high understanding of checking services for payment.
  - Every type of businesses, except small-sized rural businesses, had a good understanding of telephone and internet funds transfer/payment.
  - Few respondents understood usage of BAHTNET/Media Clearing. This was particularly true for small and medium-sized rural businesses. On the contrary large-sized businesses in the urban and rural area had a high understanding of BAHTNET/Media Clearing.
  - Generally, rural businesses had less understanding about funds transfer/payment services than urban peers.
- Risk Management: Business respondents knew and understood non-life insurance services (92.8 percent) more than other risk management tools such as swaps, options, and forwards (39.6 percent).

- Businesses of every size in urban and rural area had a high understanding of non-life insurance, while a significantly smaller number of business respondents, excluding medium and large-sized urban businesses, understood swaps, options, and forwards.
- Urban and rural businesses had relatively the same level of understanding of non-life insurance products. But urban businesses had exponentially higher level of understanding of other risk management tools than rural peers.
- Other Financial Services: Business respondents knew and understood trustee/custodian services (e.g. safety deposit box) the most (78.7 percent), followed by foreign currency trading (74.5 percent), employee provident funds (72.8 percent), business advisory services (59.8 percent), and fund management (58.6 percent) respectively.
  - A large number of medium and large-sized businesses in the urban and rural area understood other financial services.
  - Only a few small-sized businesses understood fund management and business advisory services.
  - Rural businesses had a minutely lower understanding of other financial services relative to urban peers.

#### 4.2 Financial Service Providers

- Business respondents believed that SFIs were the most stable financial service providers, followed by commercial banks and life insurance companies respectively. On the other hand, finance companies were seen as most likely to fail, followed by credit foncier companies and community savings groups respectively. However a significant number of respondents stated that they did not know the answer.
- When asked about the government's deposit insurance scheme, business respondents maintained that they believe SFIs to be the most stable financial service providers, followed by commercial banks and cooperatives respectively. On the other hand, business respondents believed that community savings groups received the least protection, followed by life insurance companies, and credit foncier companies respectively. However a significant number of respondents stated that they did not know.
- In general, the business sector's confidence in financial institutions did not vary much across the different types of financial institutions.
- Small and medium-sized businesses had more confidence in cooperatives than large-sized urban businesses.

- Businesses of every size had no confidence in community savings groups. Small and medium-sized urban businesses, excluding large-sized urban businesses, believed that community savings groups had high probability of failing more than their rural peers.

#### 4.3 Receipt of News and Information

- Business respondents felt that they were not receiving enough financial news especially those related to risks associated with financial service usage.
- 47 percent of respondents felt that they received adequate information on interest rate, expenses, and service conditions, while 53 percent felt that they were not receiving enough information.
- 36.7 percent of respondents felt that they received adequate information concerning risks related to financial service usage, while 63.3 percent felt that they were not receiving enough information.
- 38.9 percent of respondents felt that they received adequate information concerning operating results and stability of financial service providers, while 61.1 percent felt that they were not receiving enough information.
- Opinions of business respondents in urban and rural area do not differ greatly from one another on this topic. However, rural businesses were more satisfied than their urban peers in terms of information concerning operating results and stability of financial service providers.
- Respondents felt that large-sized urban businesses received more information than small and medium-sized urban businesses for every topic.

#### 4.4 Obstacles and Problem Resolution

4.4.1 Problems With Deposits and Investments (where main service providers were Thai commercial banks, hybrid commercial banks, foreign bank branches, and SFIs)

- Problems Associated with Thai Commercial Banks: inconvenient length of transaction time, complex service conditions, inflexible provision of services, low rate of return, and high fees.
- Problems Associated with Hybrid Commercial Banks and Foreign Bank Branches: insufficient number of office locations, complex service conditions, length of transaction time, and high fees.
- Problems Associated with SFIs: inconvenient length of transaction time, complex service conditions, insufficient number of office locations, and incorrect knowledge.

- In general, rural businesses had fewer problems with deposits/investment than their urban peers. Every small-sized rural business mentioned that they did not have any problems with deposit/investment services from Thai commercial banks, hybrid commercial banks, foreign bank branches, or SFIs.
- Medium and large-sized rural businesses felt that they receive unequal treatment from Thai commercial banks, more than their urban peers.

#### 4.4.2 Problems With Credit and Fund Raising (where main service providers were Thai commercial banks, hybrid commercial banks, foreign bank branches, and SFIs)

- Problems Associated with Thai Commercial Banks: complex service conditions, high fees/interest rate, inconvenient length of transaction time, too much emphasis on collateral and not enough consideration given to borrower's ability to repay, and unequal treatment.
- Problems Associated with Hybrid Commercial Banks and Foreign Bank Branches: complex service conditions, insufficient number of office locations, and high fees/interest rate. Moreover, inconvenient length of transaction time was also a problem for hybrid commercial banks.
- Problems Associated with SFIs: complex service conditions and inconvenient length of transaction time.
- Thai Commercial Banks:
  - Small-sized rural businesses tended to have more problems than their urban peers – lack of confidence in the bank's management capability and incorrect knowledge of staff.
  - Small-sized urban businesses had problems with complex service conditions, high fees/interest rate, or inconvenient length of transaction time.
  - Large-sized rural businesses had more problems with high fees/interest rate than their urban peers.
  - Large-sized urban businesses had more problems with complex service conditions than their rural peers.
  - Furthermore, medium sized rural businesses face more problems associated with unequal treatment than their urban peers.
- Hybrid Commercial Banks
  - Medium-sized urban businesses tended to encounter more problems than small and large-sized businesses.

- Small and large-sized businesses only had problems associated with complex service conditions.
- Foreign Bank Branches
  - Small-sized urban businesses tended to encounter more problems than medium and large-sized businesses, especially with insufficient number of office locations and high fees/interest rate.

#### 4.4.3 Problems With Funds Transfer/Payment (where main service providers were Thai commercial banks, hybrid commercial banks, and foreign bank branches)

- Problems Associated with Thai Commercial Banks: inconvenient length of transaction time, high fees, complex service conditions, unequal treatment, and incorrect knowledge.
- Problems Associated with Hybrid Commercial Banks: inconvenient length of transaction time, complex service conditions, insufficient number of office locations, and unequal treatment.
- Problems Associated with Foreign Bank Branches: insufficient number of office locations, complex service conditions, inconvenient length of transaction time, unequal treatment, and high fees.
- In general, urban businesses of every size had more problems with funds transfer/payment than rural peers.
- One problem that every business had with Thai commercial banks was inconvenient length of transaction time.
- Hybrid Commercial Banks:
  - Small and medium-sized urban businesses had more variety of problems with hybrid commercial banks than large-sized businesses.
  - Large-sized businesses only had problems with inconvenient length of transaction time.
- Foreign Bank Branches:
  - Medium-sized urban businesses had more variety of problems with foreign bank branches than small and large-sized urban businesses.

#### 4.4.4 Problems With Risk Management (where main service providers were insurance companies, Thai commercial banks, and SFIs)

- Problems Associated with Insurance Companies: high fees, lack of consumer protection for service usage, inconvenient length of transaction time, and low rate of return.
- Problems Associated with Thai Commercial Banks: inconvenient length of transaction time, high fees, complex service conditions, and unequal treatment.
- Problems Associated with SFIs: complex service conditions, high fees, inconvenient length of transaction time, and low rate of return.
- Small and medium-sized rural businesses had no problems with insurance companies, whereas large-sized rural businesses had some problems with insurance companies in terms of high fees, low rate of return, and lack of protection for high-risk services.
- Medium-sized urban businesses had more variety problems than small and large-sized urban businesses.

#### 4.4.5 Problems With Other Financial Services (where main service providers were Thai commercial banks, foreign bank branches, and mutual fund companies)

- Problems Associated with Thai Commercial Banks: complex service conditions, incorrect knowledge of staff, high fees, inconvenient length of transaction time, high fees, and insufficient number of office locations.
- Problems Associated with Foreign Bank Branches: complex service conditions, insufficient number of office locations, and low rate of return.
- Problem Associated with Mutual Fund Companies: low rate of return.
- Thai Commercial Banks:
  - Small and medium-sized rural businesses had no problems with Thai commercial banks for other financial services.
  - Large-sized rural businesses had a problem with insufficient number of office locations. On the other hand, their urban peers had problems with complex service conditions and incorrect knowledge of staff.
- Foreign Bank Branches:
  - Large-sized urban businesses had problems with complex service conditions.

- Small-sized urban businesses had problems with insufficient number of office locations, while medium-sized urban businesses had more variety of problems with foreign bank branches than other types of businesses.
- Overall, businesses of various sizes tended to have few problems procuring other financial services from different types of services providers. This was especially true for rural businesses

#### 5. Level of Competition in the Financial System

- Businesses felt that in general there was low level of competition, especially in terms of interest rates, fees, service modernization and developments of new channels of delivery.
- Majority of businesses did not reject the idea of mergers and consolidation among financial institutions since they believed that mergers and consolidation could help strengthen financial institutions. Rural businesses were more accepting of the idea than their urban peers. Moreover, small and large-sized businesses were more accepting of the idea than medium-sized businesses.
- Businesses felt that since there were several limitations to the entry of new players, authorities should help strengthen existing players and apply measures to promote more competition in terms of interest rate and lowering operating costs.

#### 6. Structure of Financial System

- 95 percent of funds used to finance businesses came from three main sources: personal funds, borrowed from capital market, and company's retained earning. Businesses employed much less of other sources such as informal sources, and the issuance of equity and debentures
- Small-sized urban and rural businesses mainly used their personal funds.
- Medium and large-sized urban and rural businesses tended to consider using the capital market more than smaller businesses.
- Businesses' expectations of their future sources of funds did not differ from the sources of funds that they were already using. (95 percent of total funding will still come from the 3 main sources mentioned above.)
- Large-sized urban businesses were the only ones interested in raising funds through issuance of debentures. Yet, their demand for it was relatively low.

- The problems for businesses interested in issuing debentures but had not yet done so because of the high costs that they felt did not appropriately reflect genuine business risks and high fees.