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Challenges of Restoring Investor Confidence Following a Financial Crisis.

## Challenges of Restoring Investor Confidence Following a Financial Crisis

- A. The countries of East Asia have now recovered from the late financial crisis.
- B. In Thailand, the sign of economic recovery is clear but the problems of non performing loans and corporate debt restructuring are still lingering.
- C. Several measures have been pursued to cope with the problems :
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  - CDRAC
  - Incentive framework for the restructuring
- D. Problems in the Thai capital market:
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  - stock price
- E. The causes of the problems :
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- F. The campaign to bring back the investors
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  - creating a good market system
  - empowering and protecting the investors
- G. Rationales behind the strategies
- H. Implementation of the strategies :
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    - Reducing the transaction cost of the market
    - Promoting investor's education
    - Promoting institutional investors

## **Challenges of Restoring Investor Confidence Following a Financial Crisis**

Ladies and Gentlemen,

- The countries of East Asia have now recovered from the late financial crisis. South Korea recorded a GDP growth of 13.0% in the Q4 of 1999 on a year on year basis. Malaysia also reported a 8.1% growth in the Q3 last year, while Taiwan's growth in the Q4 is 6.8%. Hong Kong (Q4 8.7%), Singapore (Q4 7.1%), the Phillipines (Q4 5.8%) and Indonesia (Q4 5.8%) also show the same pattern of continual economic recovery.
- In Thailand. the economy has picked up since the Q1 of last year. The GDP growth rate has gradually increased from 0.2% in the first quarter to 6.5% in the fourth quarter of 1999.
- Thailand's growth engine has been her exports, whose growth rate has increased from 5.7% in the Q2 last year to 25.1% in the Q4. Now investment has begun to pick up with an 11.0% increase in the Q4 last year. The government is still pursuing a budget deficit policy to ensure the economic recovery. The general public's confidence has now been revived as the consumption begins to increase with a growth of 8.7% in Q4 last Year.
- I think the sign of economic recovery is clear but two serious problems, however, are still lingering around, threatening the sustainability of the economic growth.
- We still have to deal with the problem of non-performing loans (NPLs), which are currently around 37% of the total outstanding banking system's loan. To complicate the situation further, the problem of corporate debt restructuring is also waiting for a cure.
- To cope with the NPLs and the corporate debt restructuring problems, the government has promoted and facilitated the establishment of private asset management corporation (AMC) to buy the problem loans out of the Thai financial institutions.
- A special task-force called "Corporate Debt Restructuring Advisory Committee (CDRAC)" was established by the Thai government to promote market-based corporate debt restructuring.
- Several Policy initiatives have been rigorously pursued to eliminate impediments and broaden the incentive framework for the restructuring. Those initiatives include :
  - the strengthening of the Bankruptcy and Foreclosure Laws to facilitate the restructuring process,
  - the elimination of tax disincentives for debt restructuring,
  - the revision of the Bank of Thailand's (BOT's) regulations for loan classification and collateral appraisal in line with best international practice,
  - an increased involvement of the BOT to monitor and supervise the debt restructuring carried out by financial institutions under its regulations.
- So far, the policy implementations are quite effective. The BOT expects that the NPL level will reduce to the magnitude of about 10% of total outstanding loans by the end of this year.
- Up to this point, I believe we are on the right track in solving the problems and the policies' results are also quite encouraging. It's just a matter of time before the problems lie down and I hope it's not too long.
- Right now, my concern is more on a longer term problem - the problem of how to revive the Thai securities market.
- Since the outbreak of Thailand's financial crisis in the last quarter of 1997, no new public company has been able to list in the Stock Exchange of Thailand and raise funds from the public. The old listed companies could have only 5.3% of their total new funds raised by public offering of securities in 1999.
- In the secondary market, the Stock Exchange of Thailand Index, or "SETindex" in brief, plummeted from 568 points on July 2 1997, when the Thai baht currency was floated, to the trough level at 207 points on September 4 1998 or a decrease of about 60%. The index did bounce back as the Thai economy recovered but it has never gained enough momentum to go beyond 400 points lately.

- The symptoms are obvious beyond doubt that the Thai securities market has not yet quite recovered from the crisis. As the regulator of the market, we really need to know what the causes of the symptoms are.
- To answer the question. The Securities and Exchange Commission of Thailand (SEC) launched two research studies last Year : one on the supply side of the market and another on the demand side.
- The supply side study found that the cost of fundraising by public offering of securities in the Thai capital market averaged only 3.0 to 3.9% of total funds raised which was much lower than an average of 7.1 % to 11.0% in the US. Compared to the Thai banking system, it ,was also a lot cheaper than the banks' average minimum lending rate of 13.0% during the same period of study. The corporates or the issuers of the securities seem to have sufficient incentives to supply the securities to the market, judging from the "cost" perspective.
- On the demand side, 18 brokerage and representative firms we asked indicated that the investors in the Thai securities market were losing their confidence in the market and leaving for a more attractive investment alternatives. In their opinions, there were fewer and fewer good “products” to buy and the market itself became too small to invest their funds in.
- The evidence seems to point out that the causes of the problems are more from the investors or the demand side of the market. If we could bring in the demand, the supply is already there to meet and create the market.
- As the regulators, what should we do to cure the ailing market?
- The regulators from developed markets may say “Let the market solve the problems itself. The roles of regulators are just to keep the market fair, transparent and efficient.”
- But most regulators in emerging markets can hardly do that. How can we have a fair, transparent and efficient market if the market does not even exist?
- From the studies, there has been no demand because there is no good supply of securities, and there is no supply of securities because the issuers have seen no demand. As a logical result, when there is no demand and supply, there is no market.
- Based on the results of our studies, the Securities and Exchange Commission has launched a campaign to bring back the investors.
- The campaign has focused on three strategies:
  - inducing a good supply of securities
  - creating a good market system
  - empowering and protecting the investors
- What are the rationales behind these strategies?
- As I mentioned earlier, there has been no demand because there is no **good** supply of securities. If we could create good supply of securities, then there would be more demand. And if the induced demand gains adequate momentum, the **general** supply of securities could get in and create the market. The good supply hence works as a catalyst to the market creation process.
- By implementing the first strategy, a larger spectrum of investor's risk and return preferences could be satisfied, and hence, more investors could participate. Once the market exists the second and third strategies would enhance the investor's confidence, and thus, ensure a long-term sustainability of the market.
- Now that I have presented what problems we are facing, what we believe are the causes of the problems and what strategies we are pursuing to cope with these problems, let me elaborate further how the strategies have been implemented.

- The first strategy, **inducing good supply of securities** is composed of 4 main policy measures :
  1. Making the existing tough listing requirements more flexible, particularly those on minimum registered capital, track record, and profitability, to accommodate a broader spectrum of companies, while keeping in place the tightening rules on good corporate governance.
  2. Inducing the state enterprises under the government's privatization program to list in the Stock Exchange of Thailand (SET)
    - The Corporatization Act, which has become effective in December last year, removed the legal barriers and significantly facilitated the privatization process.
  3. Inducing small and medium-sized enterprises (SMEs) which has been strongly promoted by the Thai government to list in the SET.
    - The SME Promotion Act has been enacted in February this year in order to foster the implementation of the promotion plan. Under this Act, a new government agency named "SME Promotion Office" will be established to assume all responsibilities for the promotion of the SMEs.
    - Venture capital funds have been set up to invest in the promising SMEs.
    - The Thai government has enhanced the effectiveness of SME financing by restructuring the existing specialized financial institutions, the Small Industry Finance Corporation and the Small Industry Credit Guarantee Corporation. Both institutions have been injected with sufficient financial resources to enable the expansion of their financing and credit guarantee services to the SMEs.
    - The SET has established a separate exchange called "Market for Alternative Investments" (MAI) to accommodate the trading of SME stocks. The MAI can be a market for general SMEs and medium to small companies in the high growth IT business. The MAI expects to have 6-10 listed companies initially and plans to begin the trading in the Q3 of this year.
  4. Developing bond market to provide the investors with an alternative set of products
    - Debt Management Office has been established to coordinate the debt management of the country in order to ensure the continual and consistent issuance of government bonds, which will consequentially create an interest-rate benchmark for the market.
    - Moreover, the government also issued a series of saving bonds to serve as an investment alternative for the retail investors.
    - In terms of the secondary market, 3 main measures have been implemented to promote the liquidity and transparency of bond trading,
      - Firstly, the central bank has initiated the primary dealer system by initially selecting nine financial institutions to act as its counterparties for the conduct of open market operations.
      - Secondly, the SEC is working with the Revenue Department to remove tax impediments for bond trading.
      - Thirdly, the SEC has proposed that the Minister of Finance issues license for inter dealer brokers (IDB). The regulations for the IDB are expected to be launched this year.
- The second strategy **creating a good market system**, comprises 2 main policy measures
  1. Enhancing good corporate governance practices
    - The institutional set-up of listed companies has been improved to provide sufficient check and balance mechanisms and to enhance accountability of the board of directors. In this regard, the SET required all listed companies to set up an audit committee by the end of last year. The SEC has also amended the rules for public offering of securities to require issuing companies to have effective management control mechanisms.
    - In addition, the SET has also set up the Institute of Directors and launched the codes of best practices to foster integrity, and good governance among company directors.
    - Moreover, in order to promote disclosure and transparency of information, the SEC has revised the approval criteria for securities offerings and changed the system from merit plus disclosure-based towards full disclosure-based system. The SEC has also worked closely with the Thai accounting association to improve the Thai accounting standards to conform with the International Accounting Standards (IAS).
  2. Enhancing integrity of the intermediaries and clearing and settlement system
    - Regarding the intermediaries supervision, the SEC continually improves standards of securities firms by instituting proper mechanisms for internal control, risk management, and customer protection. For instance, the net capital rule has been revised to incorporate risks of new products such as derivatives. The segregation rule has been improved to be more comprehensive and specific.
    - Furthermore, the clearing and settlement system has undergone significant developments, which enable it to meet the international standard in many aspects. For example, the securities depository has been a scripless system since 1992. In 1996, the SET and its clearing members jointly set up a clearing fund, which would receive periodic contributions from its members, to serve as the financial last resources in case of settlement defaults. In addition, the

SET has also officially backed up this clearing fund with its pledge to get in if necessary to ensure the financial integrity of the system.

- In addition, the clearing house has improved its risk management system by imposing a settlement cap that will be set accordingly to member's net capital to each member's settlement volume. The clearing house also launched an early warning system to help controlling the impact of market risk on pending settlement value.

- The last strategy, **empowering and protecting the investors**, comprises 4 main policy measures :
  1. Laying down a proper legal infrastructure to protect the investors
    - There will be significant improvement in legal infrastructure dealing with basic protection for shareholders' rights. In this regard, the SEC is now working closely with the Ministry of Commerce to amend the Public Company Act and the SEC Act in at least 3 main aspects:
      - strengthening roles and responsibilities of corporate officers,
      - making legal proceeding by shareholders less cumbersome, and
      - tightening requirements on accounts and audit to ensure proper books and records.
  2. Reducing the transaction costs of the market
    - The SEC is in the process of liberalizing the brokerage commission fee from a current fixed-rate system to a fully negotiated one. The SEC's study shows that the measure will bring the investors' brokerage expense down at magnitude of more than half of the current level.
    - The SEC also encourages and supports the use of information technology in the securities business community. Internet trading of securities has been increasing lately and I believe that the technology will certainly reduce the cost of information and transaction down significantly in the near future.
  3. Promoting investor's education
    - The SEC is working with the Ministry of Education to have the secondary school's curriculum contain the courses of capital market and investment principles
    - The Commission also assists and cooperates with the higher education institutions in Thailand in their teaching and researches pertaining to the Thai capital market.
    - For general public, the SEC is establishing a capital market information center at its office to provide all the necessary information to participants in the market.
  4. Promoting institutional investors
    - Mutual funds, provident funds, private funds etc. have been long promoted to provide professional investment services to the investors who are less knowledgeable or unable to invest by themselves.
- Toward this end, I have presented how important the investor is in the capital market. In the particular case of Thailand, the investor is at the heart of problems and solutions. The life and death of the Thai securities market can be boiled down to the issue of how the investor perceives and views this market.
- All the policy initiatives, namely inducing good supply of securities, creating good market system and empowering and protecting the investors aim to induce the investor back to the market place.
- I hope that my presentation can shed some light on how the securities market should be regulated in an emerging market environment.
- Thank you for your attention.