

## The FRA and the Financial Crisis\*

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**Chairman of the Stock Exchange of Thailand and Chairman of the Financial Sector Restructuring Authority (FRA) Mr. Amaret Sila-on recently shared his experience as Chairman of the FRA with members of the Harvard Club of Thailand at a dinner where he was the guest speaker. The speech printed below at his courtesy not only sketches a number of personal encounters and observations as chairman of the organization, but also unfolds insightful points of view on the FRA's being and its implications on the Thai financial crisis.**

Distinguished Guests:  
 Ladies and Gentlemen:  
 Fellow Alumni:

If you were to look at the FRA today, particularly at the success it has had with the various auctions, it is easy to be led into believing that it has always been smooth sailing. Nothing could be further from the truth. The FRA has had to face a variety of hurdles since its very inception. In fact, the FRA had to weather many false starts before it could evolve into the organization it is today.

To give you some feel about the obstacles that we have to face, I would like to start at the beginning. You are all aware of the initial confusion that was created when 16 finance companies were suspended in June 1997, then accompanied by another 42 institutions in August of the same year. To manage the suspended 58 finance companies taken-over, the government set up the Committee to Supervise Mergers and Acquisitions of Financial Institutions, COSMAFI for short. This committee was first chaired by a very senior government official.

As Chairman of the Stock Exchange of Thailand at that time, I was obviously concerned how events in the financial sector would unfold. But my worries could only be characterized as a keen interest, one that was shared by every other member of the business community; I merely saw myself as a passive participant in the whole situation. As a former business executive and retired amateur politician, I was under no illusion that I could or would actually play a role in resolving the financial crisis. The situation did not take on a personal dimension—at least not until I received an invitation to be the Chairman of COSMAFI in late August 1997.

For reasons still unbeknown to me, the appointment did not come easily. As the days went by, my enthusiasm gradually waned to the point that I had become largely indifferent. You see, the person who approached me to become the Chairman of the COSMAFI was the Deputy Prime Minister in charge of the IMF program and he has got to work things out with the Finance Minister. Both of these gentlemen—and they are real gentlemen—were newly appointed and relatively short of experience in the wily ways of our esteemed bureaucrats.

For example, in order to get me installed as Chairman of the COSMAFI, the existing Chairman—a very senior and quite powerful government official—had to be persuaded to resign; this might have been construed as a loss of face. Another awkward thing was that, at the time, the original COSMAFI had never been convened since its creation 40 days previously. So the official order for my appointment had to be postponed by several days in order that the existing committee could hold its first meeting and make an appropriate number of resolutions so that the previous chairman could make a graceful exit.

Then there was also the attempt to put an overwhelming number of bureaucrats on the new COSMAFI, which I was supposed to chair. To avoid another NATO—no action, talk only—I responded with my own slate of committee members, mostly from the private sector and academia.

Fortunately, I was able to persuade the Minister of Finance to accept my nominations for the committee and, with that, the second COSMAFI was established some 2½ months after the first finance company was suspended. May I say, at

this point, that the expertise and dedication of these committee members are critical factors behind the FRA's current accomplishments. That committee met everyday for over a month, with neither pay nor perks, and set up most of the rules of the game for the FRA to follow.

One of the first tasks of the COSMAFI was to set up parameters for the rehabilitation of the suspended finance companies. Conditions for rehabilitation were intentionally tough and, unsurprisingly, many players in the financial sector were upset. Needless to say, many groups did some very aggressive lobbying to persuade us and the Ministry of Finance to revise the rules of game. Despite various forms of political pressure and criticisms directed at us, I realized it was extremely important for the COSMAFI to remain steadfast in its plans, if it wanted to maintain any credibility—not only for the committee itself but also for Thailand.

More importantly, however, stringent rehabilitation prerequisites would put in place a framework for stability, especially through the enforcement of strict requirements such as a BIS (Bank for International Settlements) standard of 15 percent in the first year and 12 percent in the second year. We wanted to be doubly sure that the revived firms—if there were any—would be able to survive in the medium term. You could well imagine how the confidence of international investors would be affected if a finance company, which was allowed to resume operations, had to be reclosed only after a couple of quarters.

Any reconfiguration of the status quo will invariably create winners and, of course, losers. But it cannot always be predicted with any degree of accuracy who will come out on top, especially when there is a radical dislocation as was the case with the suspension of the 58 finance companies. That is why in all areas of society—whether it is in politics, corporations or even households—human beings have a natural tendency to resist change. Also, it is often the weakest that feel the most threatened.

Given the rising level of tension, resulting undoubtedly from both fear and uncertainty, it is understandable that the COSMAFI quickly became the target of public frustrations. Such frustrations, when transformed into constructive energy, can certainly be beneficial.

However, misdirected anger will more often than not aggravate the problems rather than initiate a solution. That was exactly what happened at the time. Politicians found reasons, many of which could not be justified, to meddle with the recovery process.

So, six weeks into the job, I handed in my resignation stating that it was clearly impossible to achieve any significant progress in face of serious political meddling as well as attempts to undermine the transparency and credibility of the COSMAFI. Soon after that the Finance Minister also resigned as the then Prime Minister forced him to backtrack on oil tax increases.

The work on several Emergency Decrees to solve the financial crisis, including the establishment of the FRA was left to be completed by another Minister of Finance. The FRA was eventually set up on 24<sup>th</sup> October 1997. With Khun Twatchai Yongkittikul as Chairman and Khun Bunyaraks Ninsananda as Secretary-General, I felt that things would work out fairly well. However, these two capable individuals chose to resign after the announcement to close 56 finance companies.

The pressures they felt must have been tremendous and I sympathize with them. To be behind the decision to shut down 56 finance companies, a landmark in the development of the Thai financial system, surely required great courage and strong convictions. Without the perseverance of such committed reformers, the problems would have dragged on much longer and the whole financial system could have fallen into an even deeper abyss. What they correctly realized was that in times of crisis, a sense of urgency and acting in a resolute manner are as critical as quality of the proposed solution.

With the resignation of Khun Twatchai, I was again asked to fill the vacant position. Reluctant at first, I finally accepted the new government's invitation to be chairman on the condition that Khun Tarrin Nimmanahaeminda, the new Minister of Finance, would guarantee that the FRA remain an independent organization, free from any political interference and that the Prime Minister was made aware of the understanding. This time I requested that Khun Vicharat Vichit-Vadakan, who had been a member of the COSMAFI as a technical adviser from the very beginning, be appointed Secretary-General.

Lest you feel that I have invited you to join me for a stroll down memory lane, I must hasten to add that there is a reason for these anecdotes. They serve to illustrate problems which continue to plague Thai society in general and the

Government sector in particular. The first problem is vested interests which have become ever more blatant in their clamor for special favors, and the second problem is the tendency for Tom, Dick and Harry to offer opinions about everything without any intention of actually solving any problems. The Thai bureaucracy is truly world-class, in its lack of resolves to get things done, despite the availability of professional skills and proliferation of creative ideas.

I have, therefore, been absolutely determined to make sure that the FRA does not fall victim to clever talks and glacial actions, and is not subsequently reduced to an organization that merely pays lip-service to reform policies. Of all the institutions involved in financial sector restructuring, the FRA must be among the most proactive and assertive. This is because, ultimately, the objective of the FRA is to rebuild confidence of international investors in the Thai financial system rather than to introduce standard solutions to please the media and local pundits, some of whom helped to bring down the system in the first place.

This is not to say that the process of redistributing distressed assets in order to solve the debt overhang is unimportant. Instead, I would like you to consider the FRA auctions as simply the mechanics for achieving a far larger goal: that is, to restore faith in and credibility of the Thai financial system, in the eyes of both the general public and foreign investors. Unless confidence is quickly regained, I fear that our task of putting Thailand back on the road to recovery will become increasingly arduous.

By conducting asset sales that are quick, efficient and transparent, the FRA believes that it can reestablish investors' confidence in three distinct manners. First, to demonstrate that the Thai government is serious in its financial reform efforts and is committed to the stated agenda. Secondly, to create reassurances that there is the knowledge and expertise available to effect viable solutions. And thirdly, to convince skeptics that the magnitude of the problems can be contained and that the solution is within the capabilities of the Thai government. In sum, the FRA strives to develop a focused strategy to create trust in our financial sector.

At this juncture, I would like to switch gears and update you on some of the progress the FRA has made. To date, FRA auctions have generated about 55 billion baht in cash from the sale of assets—almost the same amount as the recent recapitalization of Bangkok Bank and Thai Farmers Bank. Next on the block will be corporate and commercial real estate loans, which represent the largest asset class, valued at 470 billion baht. While it is true that we have only been able to dispose of only 10 percent of the book value of core assets thus far, we remain committed to the year-end target and are confident that we will be able to meet the tight schedule.

With regards to the speed of the FRA's operations, I must admit that we have received mixed reviews. On one hand, the local business community is under the impression that we are moving along too slowly and that the FRA is destroying value either by not bringing the assets to the market faster or by impeding the debt restructuring process. Foreign analysts, on the other hand, seem to indicate that asset disposal is timely and may perhaps even be too fast when one considers how re-pricing will affect the economy.

To provide you with some reference points, I would like to mention some statistics drawn from the experiences of other countries. In the United States, the Resolution Trust Corporation took 19 months to complete its first sale, valued at US\$337 million. As for Mexico, 31 months elapsed before authorities were able to close their first sale, which had an outstanding principal balance of US\$19 million. By way of comparison, the FRA completed its first two auctions of core assets, with a face value of US\$1.9 billion, in eight months.

The question of whether the FRA process is too fast or too slow is perhaps secondary to concerns that have been raised over the appropriateness of the current strategy of auctioning off core assets in mixed tranches of good and delinquent loans. One alternative would be for the FRA to separate the good loans from the bad ones and sell them in different packages. The problem with this approach, however, is that the FRA might not have the credibility or the resources to do the selections. Moreover, this option would undermine the transparency and timeliness of the FRA's actions. Therefore, we felt that it is more optimal for the buyers, who have the expertise, to decide what is good or bad and let the market determine the price.

While other questions will continue to be raised, it is perfectly clear, however, that the government had to close the 56 finance companies. Allowing those institutions to continue operating was simply not an option. At that time, it was practically impossible to ascertain how long the government would have to continue injecting funds and how much would be needed. The decision to end the bail out—or to cut the lifeline—definitely shored up investors' confidence and saved the tax-payers from more massive losses.

When the government is faced with a systemic failure in the financial system, it has no choice but to intervene. If it

were the case of a limited number of institutions going under, then a hands-off approach may have been in order. But when some two-thirds of the total number of finance companies, which account for roughly 60 percent of all assets held by the finance and securities industry, are unable to function, the referee must blow the whistle.

I would like to remind you that the FRA, by its very nature, is an interim organization with a very specific mandate. However, the effects of the FRA's actions will be far-reaching and, by setting the direction for future development of the financial system, will create irreversible precedents. Therefore, just as Odysseus had to navigate between Scylla and Charybdis, the FRA must implement financial sector reform while avoid killing either the banking or the real sector.

To complicate things further, the FRA must be forever mindful of the importance of maintaining a delicate balance between speed and recovery ratios. Should the FRA auctions be delayed by, say 12 months, the value of our proceeds would diminish in real terms. For example, given inflation of 10 percent and interest rates of 15 percent, the difference between receiving 800 billion baht today and 800 billion baht in one year from now is roughly 200 billion baht. I don't know about you, but that is a lot of money for me.

There also have been concerns raised that problems could arise if some of the finance companies taken over (FCTs), which have received significant payments from their debtors during the period between the sale date and the closing date, have received low allocations of the proceeds. To avoid any problems of this nature, the FRA will reallocate the proceeds among the FCTs to achieve greater fairness and in a manner reflecting international best practice. Since the winning bids are taken as given, there will be no reimbursement made to the bidders. In other words, reallocation of proceeds will not in any way affect the bidders. In addition, I would like to emphasize that whether the bids are too high or too low is not at issue—the market must be allowed to determine the prices. The FRA realizes that the only way to clear such a significant volume of assets, while maintaining credibility, market mechanisms must be allowed to function freely.

Although it is decidedly premature to judge how successful the FRA will be, I would like to offer some of my own assessments. Let me start first with what I feel has been the shortcoming of the FRA. Despite our efforts to push for a faster pace, I believe that we have not been fast enough. As you are well aware, the disease, which was originally confined to finance and securities firms, has begun to spread to the banks. In this regards, the FRA has not been as active or as quick as one could hope. Thus, the FRA may be perceived as having failed to help shore-up the overall integrity of the financial system.

On the other hand, at the risk of sounding pompous, I am prepared to say that the FRA has been largely successful in boosting confidence. There is a general consensus among foreign investors that Thailand, unlike some of our neighbors, has made considerable headway in tackling the problems at hand. Similarly, the international community often cites the FRA as evidence of the Thai government's commitment to reform. Comments such as these were also voiced by many members of the financial fraternities that we met during our recent roadshows. Now that I have given you my views on the issue, you can be the judge of where things stand.

In closing, I would like to end my talk this evening by leaving you with some final thoughts. It is often said in financial circles—and please forgive this slight plagiarism—it is said that capital has the sight of a falcon, the speed of a cheetah but the courage of a deer. The FRA is faced with the unenviable challenge to create an environment where some of these deers will take on the hearts of lions.

Thank you.