

SECTION B - AVAILABILITY AND FORMS OF FINANCING FOR ENTERPRISES

B1. Business financing arrangements generally

a) Is it more usual for the financing needs of these types of corporates to be satisfied out of capital (equity) raisings; retained earnings; or external borrowings?

During the “boom years”, sources of finance were many and varied. From 1987, direct foreign investment flooded into Thailand as a result of the sharply appreciating yen. The flow of direct foreign investment slackened in the early 1990's, but remained an important source. In the six years from 1987, market capitalization of the Stock Exchange of Thailand (the “SET”) multiplied twenty-four times. This was a major source of capital, but the SET index has now contracted by a similar multiple. The level of corporate savings was exceptionally high, reaching around 25% of GDP in 1993, providing a major source of corporate finance. After 1992, with liberalization of the local banking industry and expansion of finance companies, access to foreign funds became much easier. With the benefit of hindsight, most would agree there was too much finance available for corporates in Thailand. Now there is too little. Foreign investment in all forms has gone elsewhere. The stock market is not a viable source, corporate savings are negligible, finance companies have been closed and banks are not lending. There is a liquidity crisis.

b) What are the main sources for borrowing for these types of corporates?

In descending order of importance: domestic borrowing, external/off-shore borrowing (through local banks) equity raising, corporate savings, direct foreign investment, portfolio investments.

c) Is there significant competition among lenders and significant choice of sources for borrowing available to these types of corporates?

A completely different answer can be given to this question now, as opposed to 18-24 months ago. For much of the 1990's, lenders found themselves with a surplus of funds to lend. With ‘bad debts’ perhaps as

high as 40% of total loans, and the surviving banks and financial institutions having to meet strict capital requirements, the issue for banks is not so much competition, but survival. For most corporates, there is currently very little choice of sources for borrowing.

d) What is the present average rate of interest payable in respect of unsecured and secured debt?

- (insert near completion)

e) Is finance generally available for long, medium and short term borrowings?

One of the problems with Thailand's financial sector was the proportion of short term loans relative to medium and long term. This reflected the investment expectations of the entities supplying such funds rather than the needs of borrowers. Borrowers generally proceeded regardless on the expectation that refinancing could be obtained. Now local loans for any term are largely unavailable for most corporates.

B2. Central or other similar bank control or influence

a) What part does the central bank of this economy play in the regulation of the banking and finance sector? Would it intervene or seek to influence the outcome or course of events if, for example a large corporate with debt exposure to a number of banks was in financial difficulty?

The Bank of Thailand ("BOT") is Thailand's central bank. Established in 1939 to protect the economy as far as possible against the occupying Japanese, the BOT grew into an institution largely independent of political influence. The BOT's modern day role can be summarized as follows:

According to the Bank of Thailand Act, the Minister of Finance is empowered to oversee the overall affairs of the BOT with the general control and direction being entrusted to a Court of Directors which comprises the Governor and Deputy Governors, appointed by His

Majesty the King, as Chairman and Vice Chairmen respectively and at least five other members appointed by the Cabinet.

The responsibilities of the BOT can be summarized as follows:

Formulate monetary policy to maintain monetary stability;

Supervise financial institutions to ensure that they are secure and supportive of economic development;

Act as banker to the Government and recommend economic policy to the government;

Act as banker to financial institutions;

Manage the international reserves;

Print and issue bank notes.

(Bank of Thailand Act 1942, section 33)

Both the role and reputation of the BOT have been subject to change and criticism in recent years. Political influence became apparent during the Banharn administration of 1995-6. More significantly, it has been primarily blamed for Thailand's currency woes, failing to heed the IMF's repeated advice to float the Baht, and the subsequent titanic losses of reserves as a result of its futile defence of the currency in 1997.

The BOT's role is largely non-interventionist. It is concerned with the macroeconomic picture and is not equipped to intervene in specific cases. However, the magnitude of the economic crisis is such that a more proactive approach in respect of some of the Bank's responsibilities have now been allocated to other agencies. The Rehabilitation Fund, the BOT's fund for embattled finance companies, and the BOT itself, were considered lacking to deal with the size of the problem with the Finance companies. The Financial Sector Restructuring Authority was established last year for this role.

b) Is there any tradition in this economy for a ‘main’ or ‘house’ or ‘lead’ bank to become involved as a chief negotiator or leader in the case of the financial difficulty or insolvency of a large corporate borrower with debt exposure to a number of banks?

There is an observable trend amongst creditors of corporates to form impromptu creditors’ committees, with the chairperson from a ‘lead’ bank taking a lead role in negotiations. As one might expect, however, such a role is often not clear, and not infrequently differences of opinion, approach and roles between creditors may arise.

[These issues are further raised later in this working guide, so a general answer will suffice here]

B3. Assessment of borrowing risk and monitoring of financial position

a) Is assessment or analysis of lending risk widely practiced in this economy?

While the assessment or analysis of lending risk is widely practiced in Thailand, so too has been the practice of lending to “friendly” or “influential” parties, where risk assessment is ignored or overlooked.

b) If so, does the average lending bank make adequate assessment of risk analysis when contemplating lending to a corporate borrower?

Given the current state of lending institutions in Thailand and the level of non-performing corporate loans (30-49%), it would be difficult to justify an answer in the affirmative. While no-one predicted the extent of the recession, it would be fair to say that risk analysis in the past has been subsumed by personal connections between lender and borrower, and in recent pre-crash years, a surplus of available loan funds.

c) Would it be usual or common for a lending bank to regularly monitor the financial performance of a corporate borrower?

The short answer is yes, but not closely. A cursory perusal of balance sheets that may not be properly audited and review of share prices that

may be inflated by deliberately false information and well-timed insider trading, would seldom be questioned. Also, a central bank database of lending and security information is not available. Cooperation and the sharing of information between banks is not good. This has worked to the advantage of unscrupulous borrowers.

- d) *Would it be usual or common for a lending bank to be regularly supplied with copies of the financial statements of a corporate borrower?*

This would not be an uncommon contractual requirement for larger loans.

B4. Foreign bank lending

- a) *Is there a significant source of foreign bank lending in this economy?*

After the banking reforms of the early 1990's, access to foreign funds was a very significant source of borrowing, but executed through the local banks. Syndicated loans involving foreign banks were commonplace. Few foreign banks are eager to extend funds to Thailand currently.

- b) *If so, is it usual for this funding to be provided by the foreign bank/s alone or in combination with funding from local or domestic bank/s.*

Mostly, it will be in concert with local banks.

- c) *Are you able to detect whether there are significant differences in approach and funding terms when a foreign bank is involved in the lending (as compared with a purely local or domestic funding)?*

Yes

- d) *If so, what are the main differences?*

Collateral for local corporate loans will frequently include personal guarantees from directors, and depending on the policy of the bank,

equity in corporate debtor. For foreign banks, or where foreign funds are sourced through local banks, these forms of security are less preferred. Share pledges, charges on movables and immovables - which are also common forms of security for local funding - will be the main forms of collateral for foreign loans. Interest rates may vary from local rates, as will currency denominations and the ranking of creditors as to class.

B5. *Exclusive lending*

- a) *Is 'related' or 'exclusive' lending (i.e. where a corporate borrower and a bank have an established commercial relationship such that only that lender is looked to as the source of borrowing by the corporate borrower) common in this economy?*

This practice is uncommon in Thailand. While many corporates may have a bank with which it has a stronger relationship than others, it is most uncommon for corporate borrowing to come from a single source. The array of creditor banks for many of Thailand's corporates now in financial difficulties is remarkable. The practice seems to have less to do with the banks' intention to spread their lending risk, than with the surplus funds formerly available to lend, the lack of inter-bank information sharing and corporates' awareness that more money could be borrowed from more banks than fewer.

- b) *If no, what effect does this have if the corporate borrower is in financial difficulty or is insolvent?*

It is self evident that it is easier to get one creditor to agree to something than 50, especially when, say, most of the 50, even though they may agree in principle, will not commit themselves until the other creditors already have. Suffice it to say, reaching an arrangement with creditors - either informally or through the court sanctioned reorganization process under Article 90 of the Bankruptcy Act which requires approval of creditors representing 75% of the debt - is difficult and time consuming.

In addition, the fact is that insolvencies and bankruptcies have until

recently been comparatively rare in Thailand. The buoyant economy for many years, the ‘cultural’ aversion of creditors to pursue debts to such finality, and in particular the legal disincentives for creditors (inability of debtor to trade their way out of trouble, prejudice of creditors investing in insolvent corporates) are reasons why. Now, with changes to the legislation (with more to come) and an economy still in crisis, insolvency and bankruptcy has become a hot topic. Self-styled experts in the field have emerged; but what is happening in Thailand currently is unprecedented.

The point is, dealing with a large number of creditors who are facing mountainous bad debts and mass corporate insolvency in the context of new legislation without precedent, is not easy.

B6. *Syndicated lending*

a) Is ‘syndicated’ lending (i.e. where a group of banks or financial institutions join together to provide funding for a corporate borrower) common in this economy?

Following liberalization of the banking sector in 1992 with introduction of the so-called Bangkok International Banking Facility (“BIBF”), which in short enabled local borrowers to access foreign funds through local banks, syndicated lending became commonplace for the larger corporates.

b) If so:

(i) does a lead bank perform the role of ‘agent’ on behalf of all the lenders; and/or

Yes

(ii) is the concept of a ‘trustee’ (or similar) for a syndicate of banks (i.e. where the ‘trustee’ holds any security for the syndicated funding on trust for the syndicate of banks) known and/or practiced in this economy?

The concept of trusts is not recognised under Thai law.

(iii) if the corporate borrower is in financial difficulty or is insolvent what function does the “agent” or “trustee” perform?

This will, of course, depend on the contractual obligations, but generally the agent will take a lead role as between the syndicated lenders, acting as an agent of the creditors or as an attorney-in-fact to file a case against the corporate borrower.

B7. Subordinated debt

a) Is the concept known as ‘debt subordination’ (i.e. a contractual arrangement between lenders in which there are ‘layers’ of ‘senior’ and ‘junior’ debt and which has the effect of postponing repayment of the ‘junior’ debt until payment has been made of the ‘senior’ debt) recognized and practiced in this economy?

Yes, although there is no legislation that specifically covers this type of lending.

b) If so, is debt subordination recognized and/or enforced under the insolvency regime of this economy?

Subordinated debt will rank equally with other unsecured creditors in a straight bankruptcy situation, so is in this context unenforceable.

[This aspect is raised later in this working guide, so only general answers are required here]

B8. Banks and equity/debt

a) Is it permissible for banks to own equity in a corporate borrower?

Creditors may hold equity in corporates up to a maximum of 10%.

b) If so, is it permissible for a bank to convert debt to equity?

Banks cannot directly convert debt to equity.

c) Are there instances where this has in fact occurred, particularly in the context of either:

(i) in the context of an 'informal work out' as a result of the insolvency or approaching insolvency of a corporate borrower; or

(ii) in the context of a formal insolvency administration of a corporate borrower?

There are instances where this has occurred in the context of formal and informal insolvency administration of a corporate borrower.

d) In such a case, is it usual for the bank to be then represented on the management or board of the corporate borrower?

This will depend on the amount of lending.

[This aspect is raised later in this working guide, so only general answers are required here]

B9. Debt Trading

a) Is there a market for 'debt trading' (i.e. where a bank might sell or trade the debt owed to it by a corporate borrower) in this economy?

While no debt-specific market exists in Thailand, debt trading is occurring. The lead is being taken by the Financial Sector Restructuring Authority ("FRA"), a government agency conferred with the responsible for the restructuring the 58 closed finance companies. This has meant "fire sales" of assets, including debts owed to the finance companies. Interbank debt trading does occur, and is likely to increase.

Legally, banks may transfer claims and obligations under sections 306-313 of the Civil and Commercial Code:

Section 306 The transfer of an obligation performable to a specific

creditor is not valid unless it is made in writing. It can be set up against the debtor or third persons only if notice thereof has been given to the debtor, or if the debtor has consented to the transfer. Such notice or consent must be in writing.

The debtor is discharged if he satisfied the transferor by way of payment or otherwise before he has received notice of, or has agreed to, the transfer.

Section 307 If a right is claimed under different transfers, the first transfer notified, or agreed to, shall be preferred.

Section 308 If a debtor has given the consent mentioned in Section 306 without reservation, he can not set up against the transferee a defense which he might have made against the transferor. If, however, in order to extinguish the obligation, the debtor has made any payment to the transferor, he may recover it, or if for such purpose he has assumed an obligation to the transferor, he may treat it as if it did not exist.

If the debtor has only received a notice of the transfer, he may set up against the transferee any defense which he had against the transferor before he received such notice. If the debtor had against the transferor a claim not yet due at the time of the notice, he can set off such claim provided that the same would become due not later than the claim transferred.

Section 309 The transfer of an obligation performable to order can be set up against the debtor or other third persons only if the transfer is endorsed on the instrument, and the instrument itself is delivered to the transferee.

Section 310 The debtor of an obligation performable to order has the right, but is not bound, to verify the identity of the holder of the instrument or the genuineness of his signature or seal; but if the debtor acts in bad faith or with gross negligence, his performance is invalid.

Section 311 The provisions of the foregoing section apply correspondingly, if a creditor is designated in the instrument, but it is added that performance shall be made to the holder of such instrument.

Section 312 The debtor of an obligation performable to order can not set up against any transferee in good faith defences which he might have set up against the original creditor, except such as appear on the face of the instrument or result naturally from its character.

Section 313 The provisions of the foregoing section apply correspondingly to obligations performable to bearer.

- b) *If so, is debt trading common in this economy, particularly where the corporate borrower is insolvent or near insolvent?*

Debt trading is not common but is becoming more so.

[This issue is raised later in this working guide, so a general answer will suffice here]

B10. Guarantees to support lending

- a) *Is the concept of a third party ‘guarantee’ (as distinct from a security over property) to support corporate borrowing known and practiced in this economy?*

Guarantees are very commonly used to support corporate borrowing in Thailand.

- b) *Is there a law which regulates the power to take or give a guarantee?*

The Civil and Commercial Code, Chapters I-IV, sections 680-701.

- c) *Is it common or usual for corporate borrowing to be supported by guarantee/s?*

It is indeed. Guarantees from directors are required in circumstances where similar lending in other jurisdictions within the region would not involve guarantees.

- d) *If so, are these guarantees usually taken from owners/directors of the*

corporate borrower; from other corporates associated with the corporate borrower (e.g. subsidiaries or holding company); or from unrelated third parties?

Most commonly from directors/owners, then other corporates and lastly unrelated third parties.

e) Is there a law which regulates the enforcement of guarantees?

The Civil and Commercial Code, Chapters II, sections 686-692.

f) Is it easy or difficult in practice to enforce guarantee obligations?

While few legal defences are available to guarantors in Thailand, the excessive work load of most Thai courts means that there is ample scope for delay if a spurious defence is offered. Awards of costs are low and offer no real disincentive to do so. It is common practice for plaintiffs to sue guarantor as a co-defendant with the principle debtor. Once judgment is obtained against the guarantor, enforcement procedures must be instigated against the guarantor if he does not comply with the judgment. The success will depend upon the guarantor's assets.

g) Is it usual to require that a guarantor should give security over the property of the guarantor as an additional comfort to the lender?

No.

h) Does the insolvency of a corporate borrower have any effect on the enforcement of a guarantee?

Under the Civil and Commercial Code, section 698, a guarantor's obligations will end once the debtor's obligation is extinguished for any reason. If a corporate debtor is unable to meet its obligations, and such obligations have not been extinguished, then the guarantor will be liable. The liability of a guarantor of a corporate debtor who agrees to "settle" obligations for a reduced amount will be liable only for the reduced settlement amount by virtue of the Civil and Commercial Code, section

694 (a guarantor may also raise defences of the debtor against the creditor). However, interpretation of the new Article 90/60 of the Bankruptcy Act remains to be seen in respect of guarantor liability for debtor corporates undergoing reorganization.