

# MOODY'S

## INVESTORS SERVICE

### BANKING SYSTEM PROFILE

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## Thailand

### Summary

**Banking System Structure:** The Thai banking system<sup>1</sup> reported total assets of nearly THB15.27 trillion (USD482 billion) as of 31 December 2011, equivalent to 145% of nominal GDP. The sector is concentrated, comprising 16 commercial banks, 15 foreign commercial bank branches and 8 specialized financial institutions (SFIs). It is also dominated by the four largest banks, which together accounted for nearly 52% of total system assets, as of 30 June 2012. While customer deposits represent the largest source of banking system funds, comprising 79% of total liabilities, the loan books of the commercial banks are diversified and evenly distributed across major sectors.

**Systemic Support:** The government-run, Deposit Protection Agency, which was established in 2008, provides deposit insurance of up to THB50 million per depositor per bank. This guaranteed amount will be reduced to THB1 million in August 2016.

During the Asian financial crisis in 1997-98 and before the Deposit Protection Agency was set-up, the government and the Bank of Thailand (BoT) moved to prevent bank runs by having the Financial Institution Development Fund (FIDF) provide unlimited deposit guarantees.

The BoT has in the past, ordered severely distressed banks – whose operations do not affect the stability of the system as a whole -- to shut-down their operations.

**Operating Environment:** Thai banks operate in a relatively stable economic environment, characterized by a moderate volatility in GDP (4.2% of standard deviation of nominal GDP growth over the last 15 years), when compared with the banking systems of its regional peers.

The country's economy is large, with exports accounting for approximately 75% of GDP in 2011. Although massive flooding in the second half of 2011 adversely affected the economy, a rapid economic recovery is currently under way. However, the country fares poorly based on the World Bank indicators of "Control of Corruption"<sup>2</sup> (-0.37), "Rule of Law"<sup>3</sup> (-0.24) and "Strength of Legal Rights"<sup>4</sup> (5.0), suggesting a high level of corruption and insufficient legal protection for the rights of borrowers and lenders.

<sup>1</sup> For the purposes of this report, the banking system comprises the operations of (1) commercial banks registered in Thailand (including branch offices abroad), and (2) depository specialized financial institutions, namely, the Government Savings Bank, the Government Housing Bank, the Bank for Agriculture and Agricultural Cooperatives, the Export-Import Bank of Thailand, the Small and Medium Enterprise Development Bank of Thailand and the Islamic Bank of Thailand.

<sup>2</sup> The "Control of Corruption" index ranks countries in terms of the degree to which public power is exercised for private gain.

<sup>3</sup> The "Rule of Law" indicator reflects perceptions regarding the extent to which agents have confidence in, and abide by the rules of society, particularly in relation to the enforcement of contracts and property rights, the police, and the courts. The indicator also takes into account the likelihood of crime and violence.

<sup>4</sup> The "Strength of Legal Rights Index" measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders, thereby facilitating lending.

**Regulatory and Supervisory Environment:** The commercial banks are regulated and supervised by the BoT, which uses a risk-based approach and a consolidated supervisory process to assess overall performance and risk levels. All 16 commercial banks comply with Basel II requirements. Basel III standards will be implemented in accordance with the schedule prescribed by the Basel Committee on Banking Supervision (BCBS). By contrast, the eight specialized financial institutions are supervised by the Ministry of Finance (MoF).

*Sources: Moody's Investors Service, BoT, DPA, IMF, World Bank*

## Banking System Structure

### History

Over the past 20 years, the Thai banking system has incorporated significant reforms intended to develop and strengthen the country's financial system, especially after Thailand was identified during the Asian financial crisis in 1997-98 as one of countries with widespread deficiencies in their financial infrastructure. The key developments implemented by the BoT and the MoF since 1997 include:

**Stability measures in response to the Asian financial crisis (1997-98):** The Asian financial crisis began in Thailand in 1997, after aggressive speculation against the Thai baht led to serious adverse effects on the country's entire financial system. In response, the government initiated various policy measures to restore stability to the banking system, including closing finance companies, recapitalizing financial institutions through both public and private initiatives, restructuring debt, and merging weak financial companies with stronger ones.

**Adoption of the Financial Sector Master Plan (FSMP) – Phase I (2004):** Following the banking sector's return to profitability in 2001 after the Asian financial crisis, the BoT established the FSMP Committee to finalize both the strategy behind, and the key objectives of a new master plan for the financial industry. In 2003, the BoT submitted its formal FSMP recommendations to the MoF. The proposals were approved by the Thai Council of Ministers in 2004, initiating Phase I of the plan, comprising three initiatives: (1) to improve general access to financial services; (2) to increase the efficiency of financial services; and (3) to protect consumer rights.

In terms of specific reforms for the banking system, the government and BoT introduced a scheme encouraging voluntary inter-bank mergers, issued new banking licenses to promote financial access, introduced the "One Presence" policy to reduce duplication and to increase economies of scale, and widened the scope of commercial banking to universal banking, enabling banks to provide all client groups with a broad array of services.

**Implementation of the FSMP – Phase II (2010):** The Phase II policies, scheduled for implementation between 2010 and 2014, aim mainly to reduce system wide operating costs, promote competition to enhance the efficiency of financial institutions, broaden financial access, and strengthen financial infrastructure.

## Size

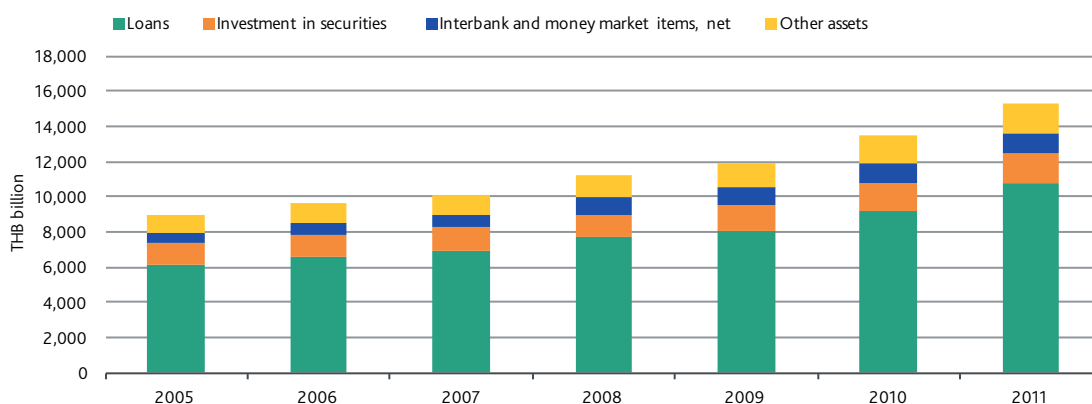
Presently, the Thai banking system includes the following institutions:

- » 16 commercial banks<sup>5</sup>
- » 15 foreign commercial bank branches
- » 8 specialized financial institutions

As of 31 December 2011, the Thai banking system reported total assets of THB15.27 trillion, equivalent to 145% of GDP. Total assets have, since 2005, increased at a compound annual growth rate (CAGR) of 9.2%. During the same period, total loans expanded at a CAGR of 9.8% to THB10.77 trillion (see Exhibit 1).

EXHIBIT 1

### Asset Growth by Segment



Source: BoT

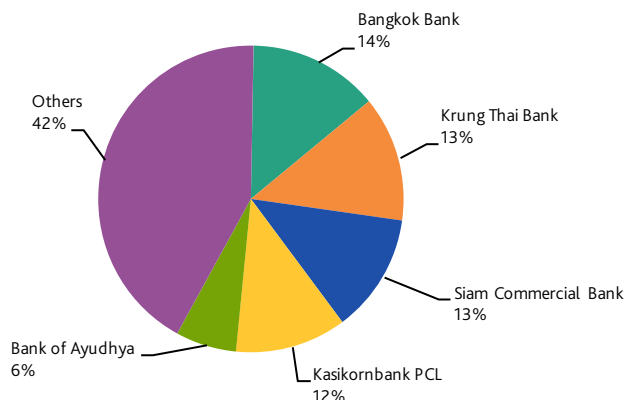
## Banking System Characteristics

### Penetration/Concentration

The Thai banking system is dominated by the four largest commercial banks, which together accounted for nearly 52% of total banking system assets as of 30 June 2012. Bangkok Bank Public Company Limited (Baa1/P-2/Stable) is the largest, with a 14% market share, closely followed by Krung Thai Bank Public Company Limited (Baa1/P-2/Negative) (13%), Siam Commercial Bank Public Company Limited (Baa1/P-2/Stable) (13%) and Kasikornbank Public Company Limited (Baa1/P-2/Stable) (12%) (see Exhibit 2).

<sup>5</sup> The 16 organizations, as classified in the institutions listing of the Bank of Thailand, comprise 14 commercial banks, a retail bank and a subsidiary of a foreign commercial bank.

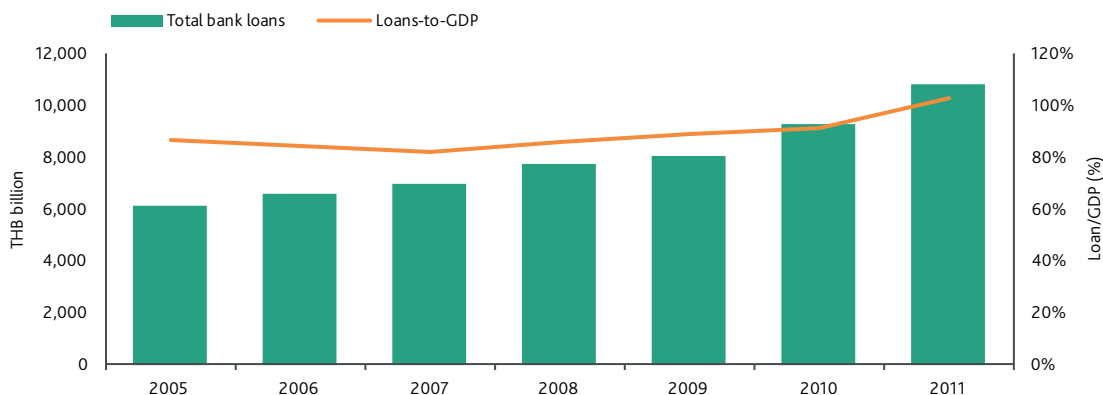
EXHIBIT 2

**Banks' Market Share of Total System Assets (as of June 2012)**

Source: Banks' Interim Reports and BoT

As of 31 December 2011, the banking sector reported total loans of THB10.77 trillion. Between 2005 and 2011, the loan-to-GDP ratio increased to 102% from 87% (see Exhibit 3) and banking sector loans expanded at a CAGR of 9.8%.

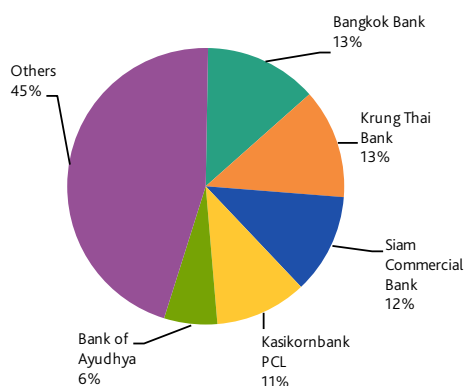
EXHIBIT 3

**Banking System Loans and Loan-to-GDP Ratio (%)**

Source: BoT (Loans) and IMF (GDP)

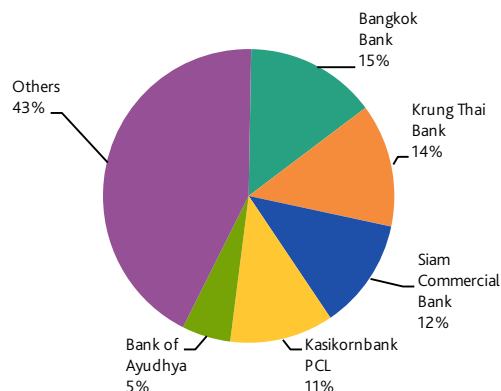
The four largest banks in Thailand, with their strong franchises, dominate the banking sector, collectively accounting for almost half the system's loans and deposits. Bangkok Bank is the biggest lender and deposit taker, with a 13% share of total system loans and 15% share of total system deposits. The bank is closely followed by Krung Thai Bank (13% and 14%), Siam Commercial Bank (12% each) and Kasikornbank (11% each) (see Exhibits 4 and 5).

EXHIBIT 4  
Loan Market Share (in %, June 2012)



Source: Banks' Interim Reports (Loans) and BoT (Total Loans)

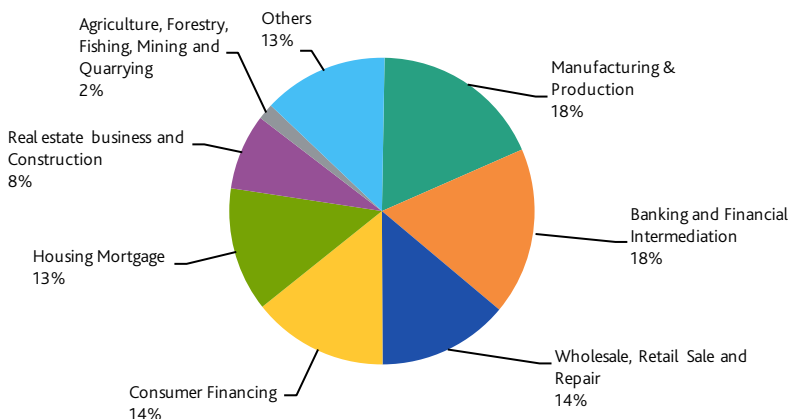
EXHIBIT 5  
Deposit Market Share (in %, June 2012)



Source: Banks' Interim Reports (Deposits) and BoT (Total Deposits)

As of 30 June 2012, the manufacturing & production, banking and financial intermediation, wholesale, retail sales and repair sectors accounted for 50% of total loans by commercial banks (see Exhibit 6).

EXHIBIT 6  
Loan Portfolio Distribution of Commercial Banks (% as of June 2012)



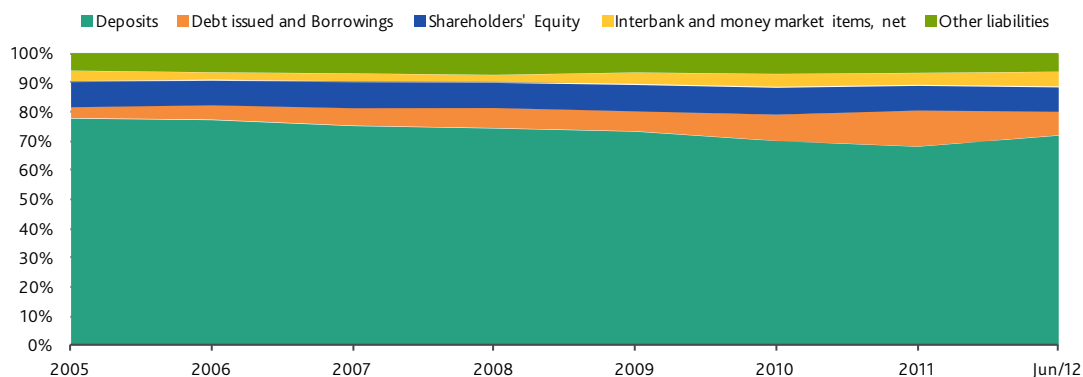
Source: BoT

Customer deposits accounted for nearly 79% of total system funding as of 30 June 2012. Most short-term deposits are sticky and typically roll over, thereby constituting a relatively cheap and stable source of funding.

When Bills of Exchange (BEs) were exempt from deposit insurance premiums, the banks attempted to lower their cost of funds by marketing the product to retail investors, on the basis that a portion of the benefits would be passed on as higher yields to consumers. However, the government has removed the exemption, resulting in a significant customer shift to deposits in 2012 (see Exhibit 7).

EXHIBIT 7

## Funding Profile of the Thai Banking System



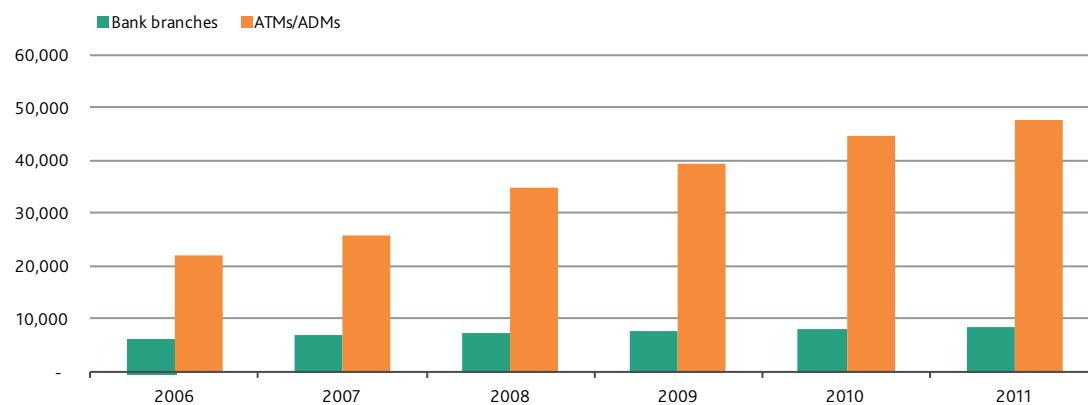
Source: BoT

## Physical Infrastructure

As Exhibit 8 shows, as of 31 December 2011, the Thai banking system had 8,423 branches and 47,759 ATMs/ADMs (automatic deposit machines). Between 2006 and 2011, bank branches expanded at a CAGR of 6%, and ATMs/ADMs grew at a CAGR of 17% (see Exhibit 8).

EXHIBIT 8

## Number of ATMs and Branches



Source: BoT

## Bank Profiles

The Thai banking system is classified as follows:

- » **Commercial Banks:** Licensed under the Financial Institution Business Act, commercial banks accept deposits and grant loans. They also buy and sell foreign currency, BEs, and other negotiable instruments. Such banks are divided into the following categories:
  - **Locally Incorporated Banks:** Domestic banks conducting commercial banking activities without restriction on the number of branches or ATMs they may operate in Thailand.
  - **Foreign Bank Branches:** Branches maintained by foreign commercial banks licensed to undertake commercial banking activities in Thailand. In accordance with FSMP Phase II, a foreign bank may operate a maximum of three domestic branches.

- **Foreign Bank's Subsidiary:** Public limited companies licensed to undertake commercial banking activities, at least 95% of whose total share capital is either directly or indirectly owned by a foreign commercial bank. In accordance with FSMP Phase II, a foreign bank subsidiary may operate a maximum of 20 branches and 20 off-premise ATMs, without restriction on location.
- » **Retail Banks:** Retail banks are public limited companies licensed to undertake commercial banking activities. Their customers are mainly retail clients and small-and medium-sized enterprises (SME). They are subject to restrictions on foreign currency, derivative, and other high risk transactions.
- » **Specialized Financial Institutions:** SFIs are government-owned, mainly deposit-taking financial institutions. Currently, eight SFIs operate in various economic sectors including agriculture, housing, trade financing and SMEs. Their primary objective is to execute government social and economic projects. They receive tax, accounting, auditing and regulatory concessions.

### Moody's Rated Financial Institutions

We rate 10 financial institutions in Thailand, eight commercial banks and two SFIs. The former accounted for nearly 89% of the total assets of commercial banks as a whole, as of 31 December 2011. The two government wholly owned SFIs we rate are EXIMT and GHB (see Exhibit 9).

#### EXHIBIT 9

#### Moody's-Rated Banks in Thailand

Bank Name	Total Assets (in THB billion) as of 31 December 2011	Domestic Market Share by Assets as of end-2011	Standalone Credit Strength and Outlook	Foreign Currency Long-Term Bank Deposit/Issuer Rating and Outlook	Notches of Uplift for Parental Support	Notches of Uplift for Systemic Support
Bangkok Bank (BBL)	2,107	13.8%	C- / baa2 ; Stable	Baa1 / P-2 ; Stable	0	1
Krung Thai Bank (KTB)	1,965	12.9%	D- / ba3 ; Positive	Baa1 / P-2 ; Negative	0	5
Siam Commercial Bank (SCB)	1,878	12.3%	C- / baa2 ; Stable	Baa1 / P-2 ; Stable	0	1
Kasikornbank (KBank)	1,723	11.3%	D+ / baa3 ; Stable	Baa1 / P-2 ; Stable	0	2
Bank of Ayudhya (BAY)	948	6.2%	D+ / ba1 ; Stable	Baa2 / P-2 ; Stable	0	2
TMB Bank (TMB)	719	4.7%	D- / ba3 ; Stable	Baa3 / P-3 ; Stable	0	3
Government Housing Bank of Thailand (GHB)	713	4.7%	E+ / b1 ; Stable	Baa1 / P-2 ; Stable	0	6
United Overseas Bank (Thai) (UOBT)	299	2.0%	D / ba2 ; Stable	Baa1 / P-2 ; Stable	4	0
Standard Chartered Bank (Thai)(SCBT)	284	1.9%	D+ / baa3 ; Stable	Baa1 / P-2 ; Stable	2	0
Export-Import Bank of Thailand (EXIMT)	74	0.4%	-	(Baa1); Stable	-	-

Source: Moody's Investors Service and banks' annual reports

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## Other Financial Intermediation:

### Capital Markets Overview

The Second National Economic and Social Development Plan (1967-71) – which aimed to establish a national capital market with appropriate facilities and procedures to enable the efficient trading of securities -- led to the closure of the Bangkok Stock Exchange in the early 1970s and the opening of the Stock Exchange of Thailand (SET) in 1975.

The SET allows for the trading of equities, bonds, derivatives, ETFs and derivative warrants. As of 31 December 2011, it had 471 listed companies and reported a total market capitalization of THB8.41 trillion. It is regulated by the Securities and Exchange Commission (SEC), an independent state supervisory agency tasked with supporting the overall development of capital markets.

### Other Non-Bank Financial Institutions

Insurance Companies: The Thai insurance sector is supervised by the Office of Insurance Commission, an independent regulator established by the Office of Insurance Commission Act 2007. The organization is responsible for regulating the conduct of insurance activities, a task previously conducted by the Department of Insurance, which is part of the Ministry of Commerce. In 2011, life and non-life insurance companies reported net premiums of THB323 billion and THB107 billion, respectively. Currently, 25 life and 66 non-life insurance companies operate in Thailand.

Finance Companies: The two finance companies that operate in Thailand accept both demand and time deposits and use these funds to grant credit and to buy and sell BEs and other negotiable instruments.

Credit Foncier: Credit Foncier companies accept time deposits from the general public. Such funds are used either to issue loans against immovable property or to buy immovable property under contracts of sale, with a right of redemption.

Pension funds: The Government Pension Fund (GPF) is governed by the General Pension Fund Act and applicable ministerial regulations, requiring at least 60% of the fund to be held in sound investments. GPF's board is charged with managing and supervising the fund, which reported THB556 billion of assets under management, as of 30 September 2012.

Provident Funds: Provident funds were created to manage private sector pension funds through various asset management companies supervised by the SEC. As of 30 September 2012, there were 443 provident funds with 2.3 million beneficiaries. Nearly 62% of the fund's total assets of THB672 billion comprised debt instruments as of 31 October 2012.

*Sources: Moody's Investors Service, BoT, Office of insurance commission, SEC Thailand, SET, GPF, Thai Provident Fund*

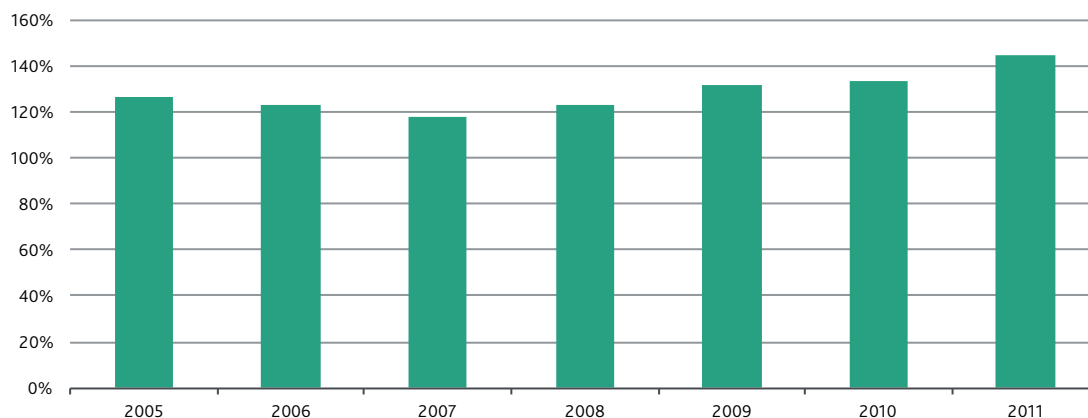
## Systemic Support

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### Importance and Strength of Banking System

With total assets of THB15.27 trillion as of 31 December 2011, the Thai banking system's assets-to-GDP ratio was 145%. Over the past five years, the system's loan-to-GDP ratio has consistently increased to 145% from 118% in 2007, owing to increases in loans and stable GDP growth (see Exhibit 10).

EXHIBIT 10

**Banking System Assets % GDP**

Source: BoT (banking system assets) and IMF (nominal GDP)

**Deposit Insurance/Protection**

The Deposit Protection Agency Act 2008, established Thailand's insurance system for deposits, which is administered by the Deposit Protection Agency (DPA). The scheme covers all deposits and accrued interest denominated in Thai baht, except for those belonging to non-residents as defined in the Foreign Exchange Control Act.

The act requires all commercial banks, finance companies and credit foncier companies to become members of the DPA.<sup>6</sup>

Members are required to pay the DPA 0.47% of the total value of their deposits and 0.46% of the total value of their non-deposit borrowings. The 0.47% payment comprises 0.01% to the DPA as a deposit protection premium and 0.46% to the Financial Institutions Development Fund<sup>7</sup> for debt servicing.

The current deposit guarantee limit of THB50 million per depositor per bank will be decreased to THB25 million from 11 August 2015, and to THB1 million from 11 August 2016.

Sources: Moody's Investors Service, DPA, IMF, International Association of Deposit Insurers

**Operating Environment****Economic Stability**

Thailand's economy is large, open and highly export-driven. Exports account for nearly two-thirds of GDP, making it susceptible to external shocks. Nevertheless, the economy is fairly diversified, comprising value-added manufacturing, tourism and agricultural exports. The country is the world's largest exporter of natural rubber, and ranks just behind Malaysia and Indonesia in palm oil exports.

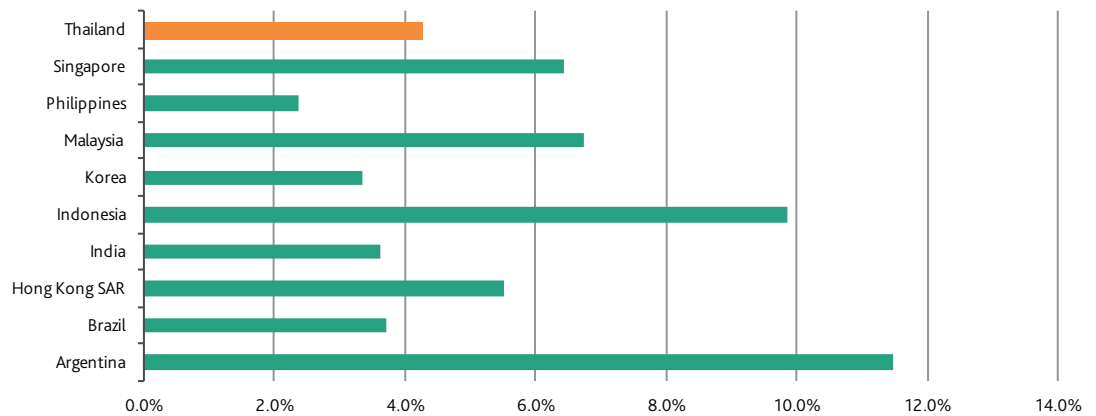
<sup>6</sup> The commercial bank members of the DPA comprise 14 Thai commercial banks, one subsidiary of a foreign commercial bank, 15 Thai branches of foreign commercial banks and one retail bank. The non-bank financial institutions which are members of the DPA comprise two finance companies and three credit foncier companies.

<sup>7</sup> The Financial Institutions Development Fund was set up during the Asian financial crisis in 1997-98, to restore confidence among creditors and depositors of affected financial institutions. The fund incurred THB1.4 trillion associated with the blanket guarantees it provided to depositors, when the government moved to shut down the operations of distressed banks. In the last 14 years, the BoT and the Finance Ministry have disagreed on which organization should be liable for deposit guarantees. Thailand's cabinet has recently given in principle approval to have the BoT take over the responsibility of deposit insurance payouts from the Financial Institutions Development Fund.

In the second half of 2011, the economy was adversely affected by prolonged floods. However, a rapid economic recovery is under way. Moreover, its standard deviation of 4.2% of nominal GDP growth over the last 15 years indicates moderate economic volatility, when compared with its regional peers (see Exhibit 11).

EXHIBIT 11

#### GDP Volatility [Standard Deviation of Annual Nominal Local Currency GDP Growth (%) over 15 years]



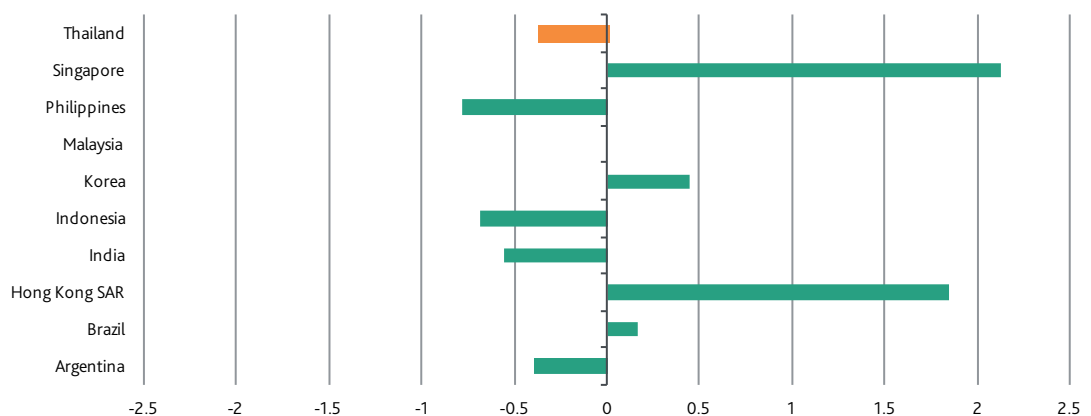
Source: IMF

### Integrity and Corruption

Thailand scores poorly (-0.37) on the World Bank's "Control of Corruption" index, relative to its regional and economic peers. However, it is favorably ranked when compared with the Philippines, Indonesia and India (see Exhibit 12). The score has largely remained range bound for the last five years, at -0.3 to -0.4.

EXHIBIT 12

#### World Bank Control of Corruption Score 2011 [-2.5 to +2.5]



Source: World Bank

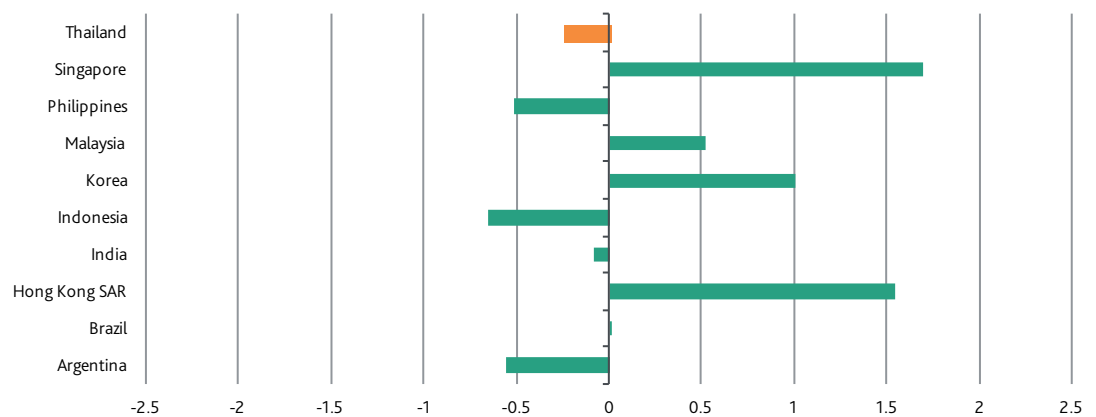
### Legal System

In terms of its legal system, the World Bank has rated Thailand's adherence to the "Rule of Law" at -0.24, suggesting a relatively weak system, when compared with most of its regional peers (see Exhibit 13). It also ranks poorly (5.0) on the "Strength of Legal Rights Index", indicating that the country's

legal protections for the rights of borrowers and lenders are weaker than the protections afforded to borrowers and lenders in other parts of Asia (see Exhibit 14).

EXHIBIT 13

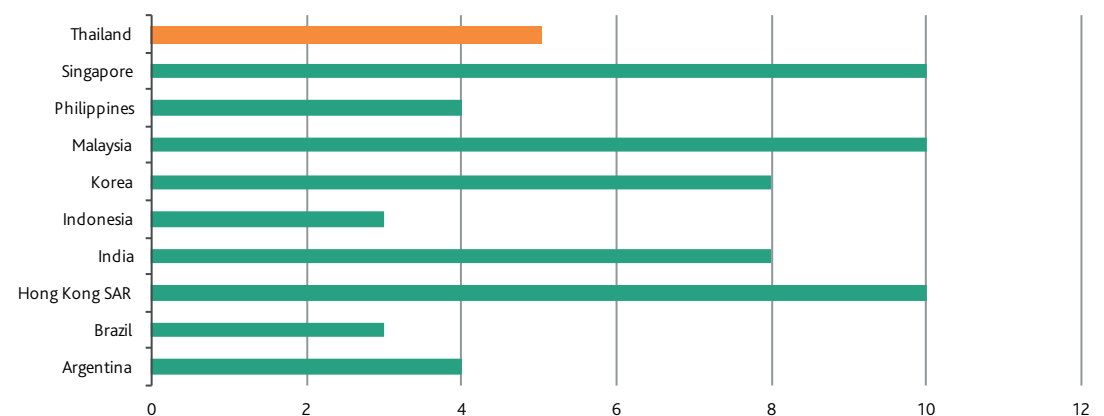
## World Bank Rule of Law Indicator 2011 [-2.5 to +2.5]



Source: World Bank

EXHIBIT 14

## World Bank Strength of Legal Rights Index 2011 (0 to 10)



Source: World Bank

Sources: Moody's Investor's Service, World Bank, IMF

## Regulatory and Supervisory Environment

### Independence

The Bank of Thailand Act (BoT Act) specifies the objectives, responsibilities and organizational structure of the BoT in accordance with international central banking standards, and consistent with the maintenance of stability and efficiency of the banking sector and payments system. In addition to being directly supervised by the MoF, the BoT must comply with various accounting regulations, financial reporting and annual audit requirements.

The BoT comprises four boards: the BoT Board, Monetary Policy Board, Financial Institution Policy Board (FIPB) and Payment Systems Board. Each is tasked with the performance of a separate central bank function. For example, the FIPB is responsible for setting prudential policy, regulations and

supervisory practices necessary to ensure the safety and soundness of financial institutions. The Financial Institution Business Act empowers the BoT to enforce prudential rules and regulations, supervise banks and impose penalties for non-compliance. The MoF reserves the right to issue or withdraw a banking license on the recommendation of the BoT.

The governor, appointed by the King of Thailand upon the recommendation of the cabinet, is responsible for the overall management and administration of BoT. The governor may hold office for a term of five years.

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### Supervision and Enforcement

Commercial banks are monitored and supervised by the BoT, using a risk-based approach and a consolidated supervisory process focusing on risk management and corporate governance assessments, designed to promote stability. The principal components of BoT supervision include off- and on-site inspections.

- » An off-site inspection involves the continuous monitoring of a bank's individual and collective financial position and performance, using supervisory and regulatory review procedures. Where breaches are identified during an off-site examination, the BOT is authorized to initiate timely corrective measures. An off-site inspection is also used to establish the scope of examination in relation to monitoring each bank's risk profile.
- » An on-site inspection involves the evaluation of a bank's financial position, performance, risk management model, and regulatory compliance. It also comprises an assessment of risks associated with bank IT operations, and a review of its Internal Capital Adequacy Assessment Process (ICAAP) to determine whether internal capital is sufficient to cover relevant risk exposures. The frequency of on-site inspections will be determined by a bank's composite rating (ranging from "1" (best) to "5" (worst)) following its previous on-site examination. All commercial and retail banks, and foreign bank subsidiaries rated "1" to "3" must be inspected on-site by the BoT at least annually. Banks rated "4" will be closely monitored, while banks rated "5" will be subject to interventions by the BoT. Bank branches overseas are subject to biannual on-site examinations if they are rated "1" or "2". Lower ratings for foreign-based bank branches attract annual on-site examinations.

In 2011, the BoT examined the financial position, performance and risk management systems of 15 commercial and retail banks, and nine foreign bank branches and/or subsidiaries. Where regulatory breaches are identified, the BoT may initiate disciplinary proceedings including penalties, written warnings, orders to desist the prohibited action or implement corrective measures, replacement or suspension of directors and senior managers, or suspension of all or part of banking operations. Ultimately, the BoT may instruct administrative control or closure of a bank following a recommendation to the MOF to withdraw its license. The BoT may also initiate the following corrective measures if a bank's capital fund<sup>8</sup> falls below the regulatory minimum:

- » The bank may be asked to submit proposals (a "project") to the BoT for approval, specifying measures to rectify any deficiencies identified. The project must include a business plan, a process to restore its capital fund, a statement indicating the level of capital funds it expects to maintain, and an implementation schedule.

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<sup>8</sup> "Capital fund" refers to (1) the paid-up capital, including premiums of shares received by a financial institution and money received by such financial institution as a result of issuance of certificates representing the rights to buy shares in the financial institution; (2) statutory reserves; (3) reserves appropriated from net profits at the end of each accounting period in accordance with the resolution reached at shareholders' meetings or the regulations of such financial institution, excluding reserves for the diminution of the values of assets and reserves for the repayment of debt; (4) net profit after appropriation; (5) reserves arising from the revaluation of assets or other reserves; or (6) money which a financial institution receives from issuing a debt instrument or an instrument or any other money as prescribed in the notification of the BoT.

- » The bank may be placed under administrative control, if its capital fund is less than 60% of the required level.<sup>9</sup> In addition, the BoT may instruct the bank to dissolve subsidiaries which appear to have insufficient assets relative to their liabilities, or would not be able to service their debt beyond three consecutive months.
- » The bank's license may ultimately be revoked if the BoT's recommendation to the MoF to do so is approved, in situations where a bank's capital fund is less than 35% of the required level.

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## Regulatory Standards

### Licensing

The MoF may issue a banking license on the recommendation of the BoT. To conduct banking business, an applicant must be established as a public limited company with the prior consent of the MoF. Once registered, it may submit a license application in the prescribed format to the MoF through the BoT. Subsequently, the BoT will evaluate an applicant's eligibility and attached business plan, thereafter submitting its recommendation to the MoF which must announce its final decision within a specified period. The BoT will also consider whether the management of the applicant company comprises fit and proper persons to hold a banking license based on the following criteria:

(1) their conduct of financial business is both ethical and professional; (2) they have not been imprisoned for any offence; (3) they have not been charged with any act of dishonesty (including but not limited to fraud), by the BoT, another government agency, or overseas regulatory body; (4) they must not be a current officer or former senior executive at the BoT, political official, or member of parliament; and (5) they must not hold a senior position in other financial institutions.

An applicant seeking to establish a commercial bank in Thailand must possess minimum Tier 1 or paid-up capital as prescribed by the MoF. Moreover, under FSMP Phase II, retail banks are also permitted to upgrade to a commercial banking license if they possess Tier 1 capital exceeding THB10 billion and can demonstrate sound operational and risk management.

The MoF grants a commercial banking license only during a specific period. Under FSMP Phase I, licenses were issued between 2004 and 2008. Likewise, under the ongoing FSMP Phase II (which started in 2010), the period to apply for new licenses will be prescribed by the MoF.

Foreign banks are permitted to establish local subsidiaries, and open branches as well as representative offices. When applying for a banking license, a foreign bank must, in addition to all other documentation, submit a written consent from its own domestic regulatory authority.

Under FSMP Phase II, an existing foreign bank branch is permitted to convert to a subsidiary, provided it possesses minimum Tier 1 capital of THB10 billion, maintains a minimum capital adequacy ratio of 12%, a maximum NPL ratio of 3.5%, and a secure sound rating in accordance with the BoT rating assessment and satisfactory risk management system. Moreover, they are allowed to open two additional branches. New applicants seeking to establish a foreign bank subsidiary in Thailand must possess minimum Tier 1 or paid-up capital as prescribed by the MoF, in the notification to allow the application of new licenses. Under FSMP Phase I, a foreign bank branch must maintain minimum assets totaling at least THB3 billion. FSMP Phase II, however, has not yet specified the new license granting scheme for a new foreign bank branch.

Section 16 of the Financial Act prescribes the following limitations and conditions concerning foreign ownership of a Thai commercial bank:

- » Foreigners are permitted to hold a stake not exceeding 25%.

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<sup>9</sup> A financial institution shall maintain its capital fund in proportion to its assets, liabilities, contingent liabilities or variables and any other risks in accordance with the rule as prescribed in the notification of the BoT.

- » Foreigners may hold a stake of between 25% and 49% subject to the previous consent of the BoT.
- » Under acute circumstances such as the need to improve the financial condition of a problem bank or to ensure systemic stability, the MoF, on the recommendation of the BoT, may allow foreign ownership to exceed 49%.

### Capital

According to capital adequacy guidelines as specified by the BOT, a bank's capital structure includes Tier 1 and Tier 2 capital. Tier 1 capital includes paid-up capital, premiums on share capital, legal reserves, reserves appropriated from net profit, retained earnings after appropriations, and requisite deductions. Tier 2 capital comprises revaluation reserves, provisions for normal assets, unrealized gains (net) on available-for-sale equity security revaluations and long-term subordinated debt instruments. The banks are subject to a minimum capital adequacy ratio (CAR) of 8.5% to cover credit, market and operational risks. They must also maintain a minimum Tier 1 CAR of 4.25%. In addition, their Tier 2 capital must not exceed their Tier 1 capital.

All commercial banks in Thailand currently comply with Basel II requirements. In addition, the domestic implementation of all Basel III minimum capital requirements commenced on 1 January 2013, two years ahead of the schedule prescribed by the BCBS. Under domestic conditions, the commercial banks have to maintain common equity Tier 1 ratios of 4.5%, Tier 1 ratios of 6%, and total capital ratios of 8.5%, which is above the BCBS's requirement of 8%. In relation to the conservation buffer, the requirement will be in line with BCBS, which will be phased in at 0.625% each year, starting from 1 January 2016. Full implementation at 2.5% will start from 1 January 2019.

### Large and Related-Party Exposures

Based on current regulatory requirements, the BoT prescribes the following exposure limits for banks operating in Thailand:

- » Retail bank exposures to an individual retail customer or SME must not exceed 11% of the bank's capital fund, i.e. 1% for individual retail customers and 10% for SMEs.
- » Any bank exposure to an individual borrower or a group of borrowers that inherit the same risk must not exceed 25% of a bank's capital fund. Such a rule does not apply to retail banks.

In addition, banks are not permitted to hold a more than 10% stake in a company's issued shares, or a stake in a company exceeding 5% of the bank's capital fund. A bank's aggregate investment must also be below 20% of its capital fund.

In terms of related-party transactions, the BoT will apply the following rules:

- » A bank's total exposure to major shareholders or businesses with related interests must not exceed 5% of its capital fund, or 25% of the total liabilities of related parties.
- » A related-party transaction must not include preferential terms or conditions which are not available to the general public.
- » A related-party transaction must be unanimously approved by a bank's board of directors.

Furthermore, banks are not permitted to grant credits or related products, or issue guarantees to its directors, managers, deputy managers, assistant managers or any other similar official, including their related persons. However, banks may grant credit in the form of credit card or employee loan.

### Liquidity

Under BoT regulations, banks must satisfy certain minimum reserve requirements, which are calculated based on an average over a fortnightly period, and which takes into account a bank's reserves. Banks must also make carry-over provisions based on their average deposits and liabilities during the previous period. In calculating a bank's reserves, the BoT will incorporate the bank's deposits, short-term foreign debt with a maturity of less than 12 months, bills of exchange, promissory notes and other index-linked debt or embedded financial derivatives.

Currently, banks are obliged to satisfy a reserve requirement ratio of 6% which must be composed of the following reservable assets: 1) a minimum 1% in non-remunerated BoT current accounts (no more than 0.2% of the bank's cash at central cash centers); 2) a maximum of 2.5% in vault cash (including excess cash in point 1) above); and 3) eligible public securities.

In addition to quantitative measures, the BoT requires banks to detail their liquidity risk management policies and procedures, and to identify, measure, monitor and control liquidity risk efficiently, using cash flow projections, behavioral adjustments, scenario analyses and stress testing.

The BoT employs open market operations to ensure sufficient bank liquidity to meet systemic demand for reserves and settlement balances.

### Asset Quality

In accordance with BoT regulations, banks are required to classify their loan portfolio, based on qualitative and quantitative criteria, into six categories: pass, special mention, substandard, doubtful, doubtful of loss and loss loan.

Substandard, doubtful, doubtful of loss and loss loan accounts are classified as non-performing loans (NPL). Net NPL refers to the NPL value net of total allowances for doubtful accounts.

Banks are required to regularly report to the BoT, their gross NPLs, their ratios of gross NPL to total loans, their net NPLs and their ratio of net NPLs to total loans, after deducting allowances for doubtful accounts of NPL.

### Loan-Loss Provisioning

Banks are required to make provisions for all loans falling within each category as follows:

- » Pass and Special mention: 1% and 2%, respectively of the difference between the outstanding amount and the collateral appraisal value as prescribed by the BoT.
- » Substandard, Doubtful and Doubtful of loss: 100% of the difference between (1) the outstanding amount and (2) the present value of expected cash flows from the debtor or the present value of the expected cash flows from seller of the collateral.

In addition, in times of growing profits, banks often make further impaired loan provisions as buffers against periods of stress.

Sources: BoT, Bangkok Bank, Kasikornbank PCL, UOBT

## Related Websites and Information Sources

- » <http://www.bot.or.th/>
- » <http://www.bangkokbank.com/>
- » <http://www.kasikornbank.com/>
- » <http://www.dpa.or.th/>
- » <http://www.set.or.th/>
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- » <http://www.sec.or.th/>
- » <http://www.oic.or.th/>

## Moody's Rated Research

### Banking System Outlook

- » [Thailand, July 2012 \(142532\)](#)

### Rating Methodologies

- » [Moody's Consolidated Global Bank Rating Methodology \(143152\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

### Definition of Banking System Profile

The Banking System Profile presents an overview of a country's banking system structure and main characteristics, including its composition, size and evolution. The Banking System Profile also describes the various elements that form our assessment of the systemic support available to banks, as well as the characteristics that are taken into account in the analysis of the regulatory, supervisory, and legal environments in which banks operate. These rating factors are an integral part of Moody's Global Bank Methodology, and are assessed in the context of the Bank Financial Strength Ratings Scorecard.

Banking System Profile publications are an accompanying report to the Banking System Outlooks. Different from Banking System Outlooks, which provide a forward-looking assessment of fundamental credit conditions that will affect banks' creditworthiness in the 12-18 months outlook period, Banking System Profiles are intended to provide an overview of the operating and regulatory framework that govern the banking system, and not opinions on the various rating factors.

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