
REVIEW OF SECURITIES EXCHANGE OF THAILAND; REPORT ON INITIAL FINDINGS

*Bureau for Private Enterprise
U.S. Agency for International Development*

Prepared by: John R. Evans

*Sponsored by: Financial Markets Project
Project Number 940-2005
Prime Contractor: ArthurYoung*

February 1987



A MEMBER OF ARTHUR YOUNG INTERNATIONAL

REVIEW OF THE SECURITIES EXCHANGE OF THAILAND

I. Scope of Initial Visit

This review of the Securities Exchange of Thailand (SET) was conducted during the three week period between July 7, 1986 through July 28, 1986. The principal purposes of this initial visit were to assess the present situation of capital market development in Thailand, in general, and the operations of the Securities Exchange of Thailand in particular. The review was intended to identify a preliminary set of actions that might be taken to improve the efficiency of SET operations, and the type of assistance that might be required in future visits.

II. Initial Findings and Conclusions

1. General Capital Market Needs are Well Known

Based on my discussions, and a review of written materials (including studies by Sidney Robbins in 1970 and 1980 and a preliminary draft of a report entitled Thai Capital Market: Characteristics and Development, by Somjai Phagaphasvivat and Pipat Pithyachariyakul) it is my view that there are many individuals in Thailand with educational credentials and a practical knowledge of capital markets and their functions. However, there appears to be a strong desire to avoid mistakes in dealing with market developments and thus a desire to seek the counsel of an outside consultant who has experience or access to experience in a more developed market. The consultant will be expected to assist in formulating revisions to current policies and practices through review and discussion of proposals developed by Thai officials. It appears also that this outside expert status can be helpful in adding confidence in the proposals and in assisting government officials to accept them.

2. Decision-Making and Administration Fragmented

Although some headway is being made both in improving the legal framework and the regulation, and public understanding is increasing, progress in capital market development has been slow. A significant part of the reason for lack of greater progress is the absence of a specific government agency, department, or office having jurisdiction over all laws dealing with securities markets development and regulation. This problem is exacerbated because of the coalition nature of the Thai government. Heads of ministries come from different political parties and sometimes have strong differences. Thus, there is a tendency to try to assure that actions are politically popular. This leads to a lack of coordination in policy and action for the development of securities markets.

Dr. Maruey, President and Manager of the SET asked that I give this issue top priority. I discovered that decision-making with respect to promotion, supervision and regulation of securities markets and their participants is fragmented among several government entities in Thailand. These include the Ministry of Finance, the Ministry of Commerce, the Bank of Thailand, and the Securities Exchange of Thailand.

3. Laws on Securities Markets not Coordinated

There are four major laws dealing with securities companies. These are: The Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business; the Securities Exchange of Thailand Act; the Civil and Commercial Code; and the Limited Public Companies Act.

The regulatory problems are evident from a quick review of these laws. The Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business provides certain regulatory standards for securities firms. This statute gives the

Minister of Finance enforcement authority and the power to set fees; issue regulations regarding the definition of businesses covered by the Act; establish conditions for the issuance of licenses; approve the formation of businesses; and, prescribe registered capital.

The Bank of Thailand under the same Act is authorized to approve or disapprove changes in the location of the main office and branch offices; establish rules of procedure and conditions for advertising; establish accounting standards; determine the form of financial statements; approve auditors; establish auditing standards; prescribe required reporting periods; and, examine and prescribe days and hours of business operation. The Securities Exchange of Thailand Act deals with some of these same matters, primarily for Exchange members and companies whose shares are listed or authorized to be traded on the Exchange. In addition, the SET may issue rules and regulations with the approval of the Finance Minister. The SET Act provides for an Advisory Board whose members are appointed by the Council of Ministers. This Board's responsibilities include advice on such matters as listing requirements, prohibiting or restricting members from effecting transactions on the Exchange, and approving rules and regulations which have been referred to the Finance Minister by the Board of Directors of the SET.

Two other laws dealing with the promotion and regulation of securities markets, the Civil and Commercial Code and the Limited Public Companies Act of 1978, are under the jurisdiction of the Ministry of Commerce. In addition to dealing with requirements for forming both private and public corporations, these laws authorize the Minister of Commerce to establish accounting and auditing standards, and the books and records requirements for business enterprises. The Minister also regulates public company offerings of securities to the public.

III. Initial Recommendations

i. New Agency Should be Established

Because of the fragmentation of responsibility and authority, I recommend that a new agency be established with the responsibility and authority to promote capital market development and to supervise and regulate all persons and activities involved in securities markets.

Because of its importance and the fact that it should be non-political in nature, it would be most appropriate that the agency be an independent organization. However, that structure appears to be foreign to the Thai governmental system. Thus, a second and almost equally desirable choice is that a separate department be set up in a Ministry. The choice, however, of which ministry it should be under is not obvious. As previously mentioned, several issues of importance to the securities markets such as registering companies, setting up accounting and auditing standards and regulating new issues of stock to the public by companies registered under the Public Companies Act, are under the jurisdiction of the Ministry of Commerce. However, the SET is under the jurisdiction of the Ministry of Finance and its recommendations and interests are funneled through the Department of Fiscal Policy, thus it appears that the Ministry of Finance would be the most logical place to establish a new Department to deal with securities markets development and regulation.

I was informed that for fiscal reasons, there is currently a policy against setting up any new departments. A proposal to establish a new department for the development, promotion and regulation of securities markets would have little chance of approval. Nevertheless, such a department is the minimum that is needed in order to properly deal with the issues. As would be expected, a department that has been assigned responsibility for fiscal policy will make that responsibility its top priority. In a

contest for attention between fiscal policy and capital market issues, capital market interests will always take a back seat to fiscal policy issues. Because there is seldom, if ever, a time when there are not pressing fiscal policy problems, this means that capital markets will not receive the necessary attention.

If establishing a new department is not feasible at this time because of fiscal constraints, a new division should be established in the Fiscal Policy Department with the expectation and goal that it will be elevated to full department status as soon as possible. In other words, something is better than nothing and something needs to be done now to simplify and unify decision-making on securities market issues.

Whether the new unit for promotion and regulation of securities markets is a separate department or a division in the Fiscal Policy Department, it should not be assigned any responsibilities other than those related to the promotion, development, and regulation of securities markets.

The new securities market office must be headed by an individual who has a good knowledge of capital and securities markets and a firm belief in their importance to the economy of Thailand. The Minister of Finance and the Permanent Secretary must have trust and confidence in his judgment and integrity. He should be a participant in all government decisions that may have an effect on securities markets. For example, if this new structure had been in place before the new tax package was announced in January, the head of the office would have been aware of the dividend tax exemption provision while it was still a proposal. He could have advised the Minister of Finance and other Cabinet officials on the negative impact the proposed provision would have on the trading of securities on the Exchange. With such prior consultation, the problem would never have occurred. Moreover, the head of the office is likely to have proposed an approach to eliminating "dividend wash trade" that would not have had the negative effect on liquidity in the market that the current solution has created.

The new office must also have a capable staff, including individuals who are competent in accounting, law, financial analysis and investigative procedures. The staff need not be large, particularly at the beginning, but should be allowed to expand as responsibilities increase.

2. Responsibilities and Authority of the New Securities Unit

One of the first responsibilities of the new securities unit should be to work with interested parties, especially Securities Exchange officials and officials in other government offices that presently have some jurisdiction over aspects of securities markets, to transfer all of the relevant responsibilities and authorities to the Ministry of Finance. These authorities would then be delegated to the new securities unit. These responsibilities would include promotion, supervision, and regulation of securities activities in both the new issue (primary) market and the trading (secondary) market.

Responsibilities in the primary market would include laws and regulations to assure that all limited companies over a certain size, measured by share owners and assets, register with the securities office; that such companies supply information required both to the office and to share owners; that appropriate information is included in all documents used in the offer and sale of securities to the public; and that regulations are established relating to underwriters and any others who may be involved in offering securities to the public.

In the secondary market, the office would have authority to deal with the registration and regulation of all brokers, dealers, investment advisers, underwriters and investment companies. It would also have the authority to regulate secondary offerings of securities previously issued and to establish standards that must be met in the trading, clearance, settlement and transferring of ownership of securities.

3. Accounting, Auditing, and Recordkeeping

Accounting, auditing and the maintenance of appropriate books and records are the heart of any disclosure system for the protection of investors and the public. In Thailand, the basic authority to issue regulations regarding standards of accounting, auditing and recordkeeping which must be met by business enterprises resides in the Ministry of Commerce. There is a very suitable structure which relies heavily on private sector bodies to establish accounting and auditing standards. It is important that the new unit for the promotion and regulation of securities markets have input to the decision-making on accounting issues. Therefore, the office would coordinate with the Ministry of Commerce and its Board on accounting as well as with the Institute of Certified Accountants and Auditors of Thailand.

4. Accounting, Auditing and Recordkeeping Standards

It is important that uniform accounting, auditing, and recordkeeping requirements apply to companies of similar structure and size. These standards would apply whether or not they are listed or authorized to trade their shares on the SET. One of the reasons companies do not list on an exchange is that the accounting and auditing requirements are more burdensome because better records are required. The solution to this problem is not to lower standards on the Exchange, but to raise the standards that apply to non-listed or authorized companies. This has the added benefits to the country of establishing a fairer tax base and making any tax benefits granted to listed companies more effective.

5. Other Reports

The new unit would establish requirements for annual and periodic reports; reports on trading by officers, directors and major shareholders; and, enforce securities laws, rules and

regulations including the imposition of appropriate penalties for violations.

6. Securities Business Professionals

The rules and regulations prescribed by the new unit for brokers, dealers, underwriters, investment advisors, and any other professional participants in securities markets would apply to all such persons whether or not they were operating on or using the facilities of the Exchange, thus bringing a minimum standard level of professionalism and ethical behavior in all securities transactions.

7. Relationship of New Securities Unit to the SET

One of the primary responsibilities of the new office will be to work with and oversee the Securities Exchange of Thailand, a legally established securities market monopoly. This will require a special relationship. Government oversight is necessary to assure that the practices and purposes of the Exchange are in the public interest and that its monopolistic position is not used to protect the interests of members unless that is beneficial to the public.

On the other hand, the private sector has the experience and expertise necessary to administer the Exchange and the profit motive can be very effective in bringing about efficient operations. Moreover, private administrators can respond much more quickly to changes in the market if permitted by the government.

8. More Authority and Autonomy For the Exchange

The most efficient way to make maximum use of private sector experience and expertise is to authorize the Exchange to determine and establish rules and regulations necessary to administer activities on the Exchange. This action would take advantage of the benefits of the motivation brought about by the possibility of

increasing returns through innovation and efficiency while protecting the public interest. This would be done under the oversight of the new governmental unit. However, only major structural changes should require approval beyond the Board of Directors of SET.

The SET Act established a rather cumbersome procedure for decision making. The Exchange has a Board of Directors, four of whom are chosen by SET members, four of whom are appointed by the Counsel of Ministers, and a full time President who manages the daily operations of the Exchange. These nine Board members choose its chairman. Although the SET Act authorizes the Board to promulgate rules and regulations establishing Exchange policies and to administer operations of the Exchange, most of its decisions must have the approval of Exchange members and the approval of the Finance Minister. Moreover, the structure includes an Advisory Board to the Minister of Finance with the responsibility to give the Minister advice. The Minister is required by law to refer most matters pertaining to the Exchange to the Advisory Board. The Advisory Board is made up of seven highly competent persons. However, they are also very busy with other full time responsibilities in government or the private sector, and do not have time to focus on SET matters in a timely fashion.

With the establishment of the proposed new unit for the promotion and regulation of the securities markets, the Advisory Board should be abolished. Decisions made by the SET Board of Directors should be sent to the new unit for its information. This would give the unit the opportunity to make comments, if desirable, within a specified period. If the unit did not object within that period, the rule, regulation or administrative determination would become effective.

As the government agency responsible for the development of the securities market, the new unit would, if deemed to be in the public interest, propose and issue its own rules affecting operations of

the Exchange, its members and firms whose securities are traded on the Exchange.

In many countries, the public is given an opportunity to comment on rule proposals. This is desirable and can improve rule making.

Other than the new securities unit in the Finance Ministry and the abolition of the existing Advisory Board to the Minister of Finance, it appears that other structural changes are not necessary. The SET Board of Directors has authority to set policy and the President has authority to administer the daily affairs of the Exchange. In essence, the President acts as a chief executive officer. Moreover, because he is a full-time official and other Board members are not, he should be most knowledgeable about Exchange operations and generally have the support of the Board in his administration. Both the Chairman of the Board and the President stated in discussions that the relationship is a very satisfactory one and they didn't believe that changes in it are necessary.

III. Future Work To Be Accomplished

Mr. Yothin Ari, Director and Assistant Managing Director of the Bangkok First Investment & Trust Ltd. made a comment at a conference held in November of 1985 that, in my opinion, outlines the important attitude for future improvements in the securities markets of Thailand. He said, "...the marginal gain from generating new ideas to boost our market is approaching a limit not far away from zero. The main question is: how many of the recommendations given by experts such as Professor Robbins, consultants from the World Bank and the ADB, etc., as well as those collected and compiled from the discussions in the board room of SET and from several domestic and international conferences held over the past ten years have been put into action?"

The task ahead, is not to do more studies, nor is it for an outside expert to try to tell the people of Thailand what they need. It is to assist them in carrying out the actions that they have already identified as needed.

The structural change that has been recommended in this report can be partially accomplished through administrative action by the Finance Minister. Part of it, however, will require changes in laws to bring together parts of various acts involving securities markets, to update the Civil and Commercial Code and to amend the Limited Public Companies Act so they will not be detrimental to development of securities markets in Thailand. This will take significant concentrated effort. It should be pointed out, however, that officials in Thailand are aware of the problems and the task of redrafting these statutes have been underway for some time. These projects deserve the input of an outside expert only to the extent that Thai officials desire.

Other areas such as the need for a higher demand for securities demand, increasing the supply of securities, improving securities laws, increasing the number of foreign investors, and encouraging institutional investors are recognized as problems. Measures are being worked on to help resolve them. It is important to obtain comments from an outside expert party on these measures.

1. SET Plans for 1986 and Long Term Plans

The SET has developed specific actions to be accomplished in 1986 as well as some longer-term projects. Significant progress continues to be made on these plans. In the area of encouraging demand, a first draft of requirements for member firms to establish authorized agents has been completed. There is a scheduled conference for insurance companies and pension funds in August to encourage them to increase their investments in equities. An open-end mutual fund for foreigners has been developed and is waiting for an appropriate time for launching. A similar fund for Thais would

be very desirable. The SET would like to develop the government bond market. At present the banking system has a captive market. Commercial banks take 40% for the portfolio, the Bank of Thailand takes 30% and the remaining 30% (which could be traded on the SET) is handled by commercial banks without a commission.

In order to increase the supply of securities, the SET is trying to increase the number of industrial firms listed. However, just last January a 10% tax benefit to listed companies was cut to 5% thus reducing the tax incentive. By the end of the year, a seminar on the benefits and desirability of "Privatization" or issuing stock to the public by public enterprises will be held with executives of those enterprises. This could be a very important source of securities without relinquishing government control of the enterprises. It could also increase employee loyalty and productivity if properly done. There is a plan to permit companies which do not meet present listing requirements because of size, lack of track record or lack of profits to be authorized to trade their shares on the SET. This is a desirable proposal. However, because of the small number of share owners and the type of company, it will be necessary to guard against possible manipulation of stock prices for these companies.

The SET would particularly like advice on its own rules governing listed and authorized companies. These include such issues as notification, approval of auditors, delisting criteria, disclosures with respect to mergers and take-overs, and measures to enforce share diversification requirements.

There are ongoing efforts at the SET with respect to setting up a share depository center, a securities information center, and a securities finance corporation. There is also a desire to have the views of an expert third party on the operation of the trading floor as to whether there is a need to make changes in present procedures for trading, clearing, settlement and transferring ownership of stock.

2. Preliminary Thoughts on Issues for Further Consideration:
Separation of Finance Business From Securities Business

It has been suggested that it may be desirable to prevent firms from engaging in both a finance business and a securities business. The reasoning behind this suggestion is that having the two activities together may have contributed to the speculation that occurred in 1978. It is also envisioned that such a separation would result in securities firms that would concentrate their efforts on underwriting, research, money management, and securities trading either as a broker or dealer.

There are presently 28 members of the SET. All but two or three of these are companies which have both a finance business and securities business. It would be very difficult to require a separation of these activities. It appears that the activity on the Exchange is not sufficient to provide a profit to 30 members doing only a securities business. In fact, only ten or twelve of the present members can be considered active on the Exchange. Thus, to require a separation would most likely result in a reduction of securities firms. There may be some basis for suggesting that a firm that is authorized to do only a securities business may concentrate more on that business. However, if the profit potential is not there, the firms would simply cease to exist. During slow times in the securities market it can be very helpful to have a diversity of activities so that a firm may remain profitable and be available when needed for securities activities. Moreover, there are satisfactory ways of regulating the activities between the finance segment of the business and the securities segment of the business so that abuses will not occur. I do not believe that at present a strong case has been made for requiring a separation between the two activities. There is even good reason to believe that it could be detrimental to the securities markets in Thailand. As financial products in Thailand become more complicated (as they have in more developed markets) having both financial and securities aspects, it may well be impossible to separate the

activities completely without a detrimental effect on consumers. Therefore, for the above reasons, I believe that it would not be desirable to require a separation between finance companies and securities companies in Thailand.

If the recommendation is accepted to establish a separate department or division in the Finance Ministry to regulate securities activities, regulation of the two segments of business will be separated with securities activities under the new unit and finance under the Bank of Thailand (BOT). This would require careful coordination between the Ministry and the BOT, but should assure equality of regulation of firms in each activity.

3. Market-making

One of the questions that faces the SET is how to add depth and liquidity to its market. It has been suggested that certain members who have the right to act as both brokers and dealers should be required to make markets in certain assigned stocks. Of course, it is advantageous to have individuals who stand ready to buy and sell securities in order to improve liquidity. However, by its very nature, a market-maker is expected to buy in a declining market and sell in a rising market. To the extent this "price stabilizing" activity is performed, it results in losses for the market-maker. Thus, market-making does not function well where there are many inactive stocks and only a few that are active. There must be an opportunity to make sufficiently extra profits on the active stocks to more than offset the losses taken on the inactive ones. I seriously question whether this condition exists on the SET at this time. Moreover, as a theoretical matter, to the extent that a market-maker fulfills his function toward creating "an orderly market", he is interfering with what the price on the Exchange would be as result of free bids and offers by investors. This makes the market less efficient as a pricing mechanism. Perhaps an arrangement can be made to improve liquidity on the Exchange without these disadvantages.

4. A Unified Securities Law

It might be desirable to have one law dealing with all aspects of securities market promotion, administration and regulation. However, that is a task requiring many years, and experience in the United States and elsewhere would indicate that gradual changes in present laws is a more viable approach. For example, changes need to be made in the Civil and Commercial Code, the Limited Public Companies Act, the Act on the Undertaking of Finance Business, Securities Business and Credit Foncier Business, as well as in the Securities Exchange of Thailand Act. Some progress is being made on each of these. In addition, since accounting is the heart of disclosure requirements for the protection of investors, it may be desirable to have accounting requirements within the same law. As stated earlier, however, these laws are under the jurisdiction of various government bodies. While most of these laws should be brought together under the proposed office, it seems to me that accounting and auditing requirements and oversight of standard setting in these areas might well remain in the Ministry of Commerce. This would make it possible to coordinate accounting and auditing requirements for all businesses in Thailand and to assure that those that are not members of the Exchange have good accounting and recordkeeping practices and acceptable audits, just as is required of those that are listed or authorized to trade on the Exchange.

5. Share Depository Center

A number of individuals in Thailand would like to set up a Depository Center in order to immobilize share certificates and improve the process of transferring ownership of securities, shareholder communications, and dividend payments. A subcommittee appointed by the SET has been studying the issue for nearly two years. It appears that the problem is not how to set it up, or the appropriate structure, but who will pay for the facility, how it will be used and whether it would be cost effective.

At this time, all trading in listed securities and authorized securities must take place on the Exchange floor. Large trades are not part of the auction process with Exchange permission, but they are still done on the floor.

Clearing and settlement also take place at the Exchange on a set basis with the Exchange being on the other side of all settlements. Transfer and registration of shares is done by the Exchange for about half of the transactions. The other half are done by institutions such as banks that have their own facilities. (They claim their facilities are as efficient as those of the Exchange.) The number of shares traded does not result in a paper work problem nor was there such a problem at the height of trading in 1978. It is very doubtful that the expense of a depository would be offset by savings at this time. The issue could use some attention, however, to determine whether a simple system would be desirable, whether banks would be willing to shift the functions now performed in-house to the Exchange, and what might be useful in the future.

6. Stockwatch and Surveillance

Having seen the stock watch and surveillance systems at the New York Stock Exchange and the American Stock Exchange, Thailand Exchange officials would like outside opinion as to whether they need to upgrade their systems.

It is important to understand the system of trading on the Exchange floor and the degree of activity. The system is a post-on-board auction system. Agents of member companies post their bids in a buying column on a blackboard and their offers in a selling column. If other members have better quotes, they displace those on the board. A member having an order that corresponds to the quote displayed, goes to the board and makes the trade with the buying or selling member. The selling member makes a record of the sale which

both he and the buying member sign. He also makes up a sales contract in triplicate with a copy for the seller, one for the buyer, and one for the SET. All transactions are cleared through the SET on the third business day following the trade day. There are staff members of the SET present on the floor and they attend every transaction. They also take the record of the transaction, time, price, buying broker and selling broker for recording in the Exchange computer. The point is, there is already a stock watch system and a system of surveillance in existence. It appears that the degree of trading is not such as to warrant a more complicated system. All that is necessary at this time is for the staff members present on the floor to be aware of what to look for and what to do if abnormal trading occurs. However, the Exchange is installing a larger computer and it may be desirable to look into the possibility of automating the trading process to some extent in the future. That would be the time to include provisions for an off-the-floor system to oversee trading on the floor.

7. Take-overs, Mergers, and Other Acquisitions

Thailand does not have provisions in a statute dealing with mergers and acquisitions. The problem of unfriendly take-overs is not a serious one in Thailand because most companies have a controlling shareholder or family. However, there have been instances in which minority shareholders have apparently been unfairly treated. A long range solution requires a change in the law. Because this would take some time, Dr. Somjai Phagaphasvivat, a member of the SET Advisory Committee has developed a rule proposal dealing with the problem for Exchange listed and authorized companies. This proposal was not in English, but he is to get it translated and will send it to me for comments and suggestions. They do not want to wait until a possible second visit in late January or early February.

8. Future Visits to Thailand

As best I could determine, it appears to me that Dr. Maruey (President of the Exchange), Mr. DusdeeSavasti-Xuto (Chairman of the SET Board of Directors), Members of the SET staff, and Lawrence Brown (Regional Private Enterprise Advisor for USAID) thought future visits could be helpful to the interests of the Exchange and to the development of the securities markets in Thailand.

APPENDIX

Sources of Information on Thailand's Capital Market and Related Matters

In keeping with the purpose of the initial review of the SET, a significant amount of time was devoted to a review of existing laws and regulations pertaining to capital market development and the operations of the Securities Exchange of Thailand. In addition, meetings were held with a number of individuals and groups who are participants in the development and operation of capital markets in Thailand. Discussions with government officials included representatives from the Ministry of Finance, the Ministry of Commerce, the Bank of Thailand, and the Industrial Finance Corporation of Thailand. Officials of the Securities Exchange of Thailand (SET) with whom meetings were held included Dr. Dusdee Savasti-Xuto, Chairman of the Board, Dr. Maruey Phadoongsidhi, President and Manager, other members of the Board of Directors, all of the Assistant Vice Presidents, managers of all of the operating departments of the Exchange, and Drs. Pipat Pithyachariyakul, Somjai Phagaphasvivat, and Paiboon Sareewiwatthana, advisers to the SET. I also met with members of the subcommittee to study and make recommendations on a stock certificate depository in connection with the SET. From the private sector, I had discussions with members of the Board of Directors of the Association of Members of the SET, the Deputy Managing Director of a major accounting and auditing firm, a company whose securities are listed on the SET and a company which had elected not to list its securities.

Because of the general election held on July 27, and the probability that some of the ministers would be replaced, there was no attempt to obtain a commitment of any kind, but even in these visits, issues relating to the SET and Thailand's capital markets were discussed.

I also had the opportunity to spend some time with U.S. Ambassador to Thailand, William Brown, and other Embassy officials as well as to discuss securities market issues and deliver an oral report on the initial visit to Lawrence Brown, Regional Private Enterprise Advisor.