

To demutualize or not to demutualize, that is not the only question

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Deputy PM Kittirat Na Ranong has made it clear that the Stock Exchange of Thailand will not be demutualized, at least not under the present government.

The topic of SET demutualization has attracted much debate in public, but it is important to understand the policy questions behind the proposed demutualization law, which go beyond merely transforming the SET into a listed company. The questions are: (1) should the law continue to uphold the monopoly status of the SET? (2) should access to the trading system continue to be limited to only securities companies in Thailand? and (3) what is the appropriate governance structure for the SET?

(1) Should the law continue to uphold the monopoly status of the SET?

Some might say that there is nothing wrong with the SET having a monopoly status. Many see no need for another exchange or trading platform in Thailand. But our view is that the SET needs to compete with other markets regionally and globally to attract funds to finance domestic growth. Experience of other markets shows that competition leads to greater efficiency. Therefore the proposed demutualization law would allow competing exchanges and trading platforms, thereby giving investors and companies more choice and stimulating continuous development for the SET to the benefit of investors and Thai companies.

(2) Should access to the trading system continue to be limited to only securities companies in Thailand?

Most exchanges used to have rules that limit trading access to members only as well as limit the number of members. But in the past decade competition for business has driven many exchanges to open up trading access by way of demutualization, i.e.

transforming from a brokers' club to a corporation, and separating ownership right from trading right.

For Thailand, this restriction exists in the securities act rather than exchange rules. The Act states that trading orders can only go through member securities companies. This can be a serious obstacle for any meaningful exchange linkage initiative including ASEAN linkage program, since foreign brokers without a Thai license must always go through brokers in Thailand to place orders. While this seems to benefit Thai brokers, investors must bear additional transaction costs, resulting in our market becoming relatively less attractive. The proposed demutualization law would remove this restriction from the law, thereby giving the SET the flexibility to open up trading access, should they wish to pursue such strategy.

(3) What is the appropriate governance structure for the SET?

Some might argue that the SET's present governance structure of a non-profit semi-mutual organization, where half the board comes from brokers and the other half chosen by the SEC, is already the most suitable structure. There is a concern that a for-profit exchange might raise fees to make more profit, and also that a small exchange like SET could be easily dominated by a major shareholder, be it a broker or bank or a foreign exchange.

The SEC takes a different view that given such a dynamic and competitive business environment that exchanges operate in today, the SET needs a governance structure that allows greater flexibility and agility than the current structure where control is divided between brokers who would naturally be inclined to give priority to their interest, and SEC appointees who might not have a lot of direct expertise in this business.

The proposed law also addresses other concerns that have been raised, particularly the possibility of dominance by a major shareholder, and the conflicting roles between the exchange's regulatory function and commercial function. Ownership by any investor in the SET shares will be limited to 5%. There will be a cap on foreign ownership, and the SEC will be the one to regulate the listing and trading of SET shares should the SET decide to self-list. As for the possibility of a for-profit exchange overcharging fees, we think it is not likely if competition is allowed.

It is not true that the demutualization proposal was motivated by the desire to split up the wealth of the SET. Under the proposed law, the major shareholder of the demutualized exchange will be the Capital Market Development Fund , which will be governed by a board comprising industry and government representatives and will be given a mandate to finance market development initiatives such as investor education, capacity building for capital market professionals, and other necessary market infrastructure to ensure continuing market development. This is similar to the arrangements in Singapore and Malaysia when their exchanges were demutualized.

The authority to decide whether or not to go forward with SET demutualization rests with the Finance Minister, and I believe the decision has been made with the best intention. Therefore this article is not meant to reopen the subject for reconsideration at this time. The intention is simply to record the real rationale behind the proposed demutualization law, to facilitate future in-depth study of this subject by interested parties.
