

## **Future Development of the Thai capital market**

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The Chairman of the Foreign Banks' Association  
Ladies and Gentlemen

1. It is my pleasure to accept the invitation to speak at the FBA dinner tonight. Foreign banks have had a long and important role in Thailand's financial landscape since over 100 years ago, starting with Hong Kong Bank. That role continues to the present day. You have been an important voice in encouraging the setting up of standards, the introduction of high technology, the catalyst of competition and modernization without which the Thai financial industry will be nowhere near the stage as it is today.

2. However, even though much has been achieved, much also remains to be done. I very much hope the foreign banks will continue to lend their helping hands, to continue to play their important roles, in our future efforts.

### **Importance of capital market**

3. Ladies and gentlemen. As you are an important voice, I have a message for you. Today I wish to share with you my view about future development of the Thai capital market, which is the scope of my new job. What needs to be done, and how to get there. My task should not be too difficult -- because for this audience, I should not have to explain much about the importance of the capital market. But I think I might have to, because at this juncture, capital market is particularly important for Thailand - for three reasons.

4. **First**, in the area of international trade. With increased competition from China and other low wage countries, Thai manufacturers have no choice but to improve on productivity.

5. This applies to those on the offensive in the export market, as well as those on the defensive in the domestic market. And for the exporters, it applies to those who compete with the low wage countries in selling to the third market, as well as those who sell goods for domestic consumption in the low wage countries themselves, China being our fastest growing market. They all have to improve their productivity. And they can only do so by investing in new machines and tools, which naturally require capital. An efficient capital market is thus a necessary condition in improving our country's competitive ability.

6. The **second** reason is that of our aging population. Even though Thai demographic is somewhat younger than the European and the Japanese profiles, the population is gradually aging. They will want venues to help themselves, to derive investment income for their retirement, to look after themselves and rely less on the government. This need is set to grow steadily in the coming years. The capital market therefore must be urgently developed and expanded to cater for this need.

7. The **third** role of the capital market is to circulate savings towards investments. But this must be done not only in Thailand. We have to make this happen on the regional scale, throughout the Asian region. Trade among the Asian countries will keep on increasing. They will become more and more closely integrated. Naturally, financial flows will have to increase.

8. Therefore, the development of capital market must also address this issue of international dimension.

### **Long term plan**

9. Well, I can see now that I have left you all with no doubt about the importance of the capital market. This has been easy. However, to convince you that we in Thailand can make a lasting improvement in this area is perhaps going to be more difficult. But I shall try. I shall start by telling you a bit about our long-term plans.

10. One of the major issues that have often been raised about our stock market is that even though there are approximately 400 companies listed but the stocks that have depth and liquidity are concentrated in only the top 50. This is not enough to satisfy large long term institutional investors who want to be assured of orderly entrance and exit into the market. In addition, such investors, once they are exposed to the market will want to have hedging instruments or channels through which they can exercise opposing views to the trend of the market. I am happy to report that both of those issues are being addressed.

11. On the issue of market depth, this year will be a record year for initial public offering of securities with perhaps more than 50 companies waiting to float their shares to the public. Numbers alone will not tell the whole story. Many of the new listing will be our large state enterprises. They will add both depth and variety to the market. In the past year we welcomed Thai Airways, Siam City Bank and Krung Thai Bank. The line up this year includes such gigantic listing as electricity authorities, telecom authorities and the Airport Authority.

12. As for hedging instruments, development will start from basics. We shall facilitate securities lending and borrowing. We shall develop standardized legal contracts for this. We want to make it easy to conduct short sale of securities both in the debt and equities markets. We shall also set up the derivatives exchange. A mid year time line has been proposed for the new market to be authorized. Trading is ambitiously planned to start by the end of this year.

13. In addition to market deepening and development of market tools, we have also introduced measures toward good governance. We shall start the process for assessment for ROSC, Report on Observance of Standards and Codes, this quarter. We have introduced handbooks for company directors. We have set up a national committee on corporate governance chaired by the Prime Minister, no less. And we have various rules to oversee orderliness in the stock market. You can see that we have launched quite a few initiatives, but why are some foreign analysts still not convinced that we can properly develop our capital market? Why are some of you here still not convinced?

**Three urgent problems-  
Price manipulation**

14. To address this concern, I wish to talk about three other important problem areas that we still face today, and how we intend to solve them. How we intend to solve them not so just in form, but in substance. This time, to be effective.

15. The first problem is share price manipulation. Being the Secretary-General of the SEC when the market was in the doldrums did not attract too much controversy. When trade volume was small, when prices were more or less static, there was not much need for police work. There were few complaints. The problem starts when the market picks up, which is happening in Asia today. When trade is heavy, when prices swing about a lot, there are big profits to be made and lost. That is when accusations start to fly about manipulation, whether real or perceived.

16. I asked myself, how can the market grow and attract small investors, especially investors far away from Bangkok, if the only way to make money is that you have to be close to the main kingpin players, the price manipulators, or to have to always keep your ears glued to the rumor circuits? We have to make sure that one can really buy stocks based on fundamentals, based on proper analysis, without having to run fast in and out of the market wasting money on commissions.

17. So what to do? My plan is to change from the previous practice of forensic investigations to pre-emptive moves. The new plan is for the Stock Exchange to move immediately after erratic price movements have been detected. The Stock Exchange together with us will call the brokers in which these transactions are concentrated. We shall suggest to them to reduce credit lines of those clients who are heavy traders in the targeted stocks. The credit line reduction will be temporary, until price movements of the targeted stocks go back to normal or until the clients lessen their activities in those stocks.

18. This can be compared to gangs of motorcycle drag racing that some time goes on at night in Bangkok. What they need is a clear open road and full tanks of petrol. Instead of waiting for the morning after in order to start investigating the tire tracks, trying to trace back to the riders, piecing together circumstantial evidences, we will change to setting roadblocks and taking away their petrol rations.

19. In short, we will change to creative disruption of their tempo. A major challenge in this approach, of course, is how to avoid unequal treatment. Since a few stocks are owned by politicians, we must ensure that the Stock Exchange applies the same rules to everybody. Not only must we ensure that it is so, but the public must also see that this is so. To ensure fairness, the Securities and Exchange Commission will therefore start making formal examinations of the Stock Exchange every 3 months.

**Settlement risk**

20. The second problem is that of settlement risk among the brokers. The current rules allow for settlement 3 days after trading. There is therefore a substantial systemic risk should the stock market suffer an unanticipated shock accumulated over the 3 days period. It could be a domestic shock, or a repercussion passed through from foreign markets.

21. The best solution is perhaps for the clearing system to move from T plus 3 days to T plus one day. However, this will take some time to develop. Therefore, unless and until this has been changed, I have to ensure that the granting of credit line by brokers to clients do not exceed prudent limits. The limits should take into account the financial status of the clients as well as the capital strength of the brokers themselves. Right now there are various rules that apply to margin loan accounts. However, for cash accounts, which are today by far the main bulk of their trade, the rules are still lacking. But most importantly, the limits have to take in account the different levels of risk brought onto the brokers by the individual clients' stock purchases. Highly speculative stocks whose prices are more volatile obviously cause more exposure to risks for the brokers than the blue chips. I therefore want their clients' individual credit lines to be adjusted accordingly.

22. To help the brokers assess their own risks better, and at the same time provide us with relevant and timely information, the SEC has started calculating and publishing a list of the 50 most active stocks in term of share turnover compared to their free floats. Free floats are the stocks not held by controlling shareholders and their strategic partners. Not all of these 50 most active stocks are worthy of worry. We shall concentrate only on those whose prices have exceeded comfort levels. At the moment we shall define them as stocks whose price earning ratios exceed 100 times or those stocks the issuer of which still suffer operating losses.

23. The brokers will have to file weekly reports to us showing the amounts of these stocks bought by their clients and how much of their businesses are reliant on those stocks. In time, we shall want to discuss with them what they do with the information. How much credit line have they reduced, and if not, why not. Have they been successful in diversifying their clients away from the heavily speculative stocks, and if not, why not.

24. I have also proposed for the association of securities companies to work out among themselves the different weights to be assigned to stocks in the lists. The weights will determine how much credit line is to be reduced for each stock purchase. For example, a weight of 2 means that for a Bht 1 million purchase, Bht 2 million will be deducted from the credit line.

25. You see, by temporarily cutting down on clients' credit lines for stocks with high PE multiples that are heavily churned, as well as those whose price movements seemed to be unusual, I am hoping to deal with the first two problems, price manipulation and systemic risk at the same time.

### **Corporate governance**

26. The third problem area is perhaps the most difficult. The problem is that of corporate governance, or to be more precise, the lack of corporate governance.

27. The cases that I had seen investigated at the SEC here in Thailand had not been the downright frauds – the type well hidden in the accounts like the famous names that we heard from abroad, Permalat being the latest one.

28. Instead, they often involved top executives who are linked to the major shareholders siphoning money out of the company to the detriment of the small shareholders. These transactions were not hidden in the accounts in any way. In fact they were plain as day.

29. If one looks at these cases from a distance, they often look like losses incurred by the companies as a result of bad business decisions. They may look like the normal cases of poor judgment or unlucky breaks that could happen anywhere. However, on closer look, virtually all of these incidents were deals involving major shareholders either directly or indirectly. And virtually all of them ended up as bad debts or bad investments.

30. The problem is that these transactions were invariably approved in shareholders' meetings either before or after event. Why the small shareholders should go along with all these proposals still puzzle me to this day! Perhaps the approvals were obtained because the small shareholders did not really understand the implication and voted along without full information. Perhaps the quorum or the votes were not properly counted and monitored, particularly those belonging to the major shareholders that are not eligible to be counted because of conflict of interest.

31. So what could be a better approach? I am hoping that we can pre-empt such moves. We shall require companies to alert the SEC of shareholders' meetings in which a decision involving conflict of interest by major shareholders or company executives will be voted upon. The SEC will review the disclosure materials, and if they are found to be too hard to understand, or biased in favor of the major shareholders, we shall either force more analysis to be made, more publication in simple terms and more debate in public about the implication for the small shareholders.

32. We will also explore the possibility of requiring the company to hire an outside legal firm and an audit firm to scrutinize the votes in these particular meetings. The SEC may also send officials to observe some of these meetings. I am sure that we cannot stop all siphons, but we can certainly make sure that they are all done under bright spotlights, under the glare of media, spiced with a lot of debate, and with proper vote counts at the shareholders' meetings.

### **Concluding remarks**

33. There you are, ladies and gentlemen. I have laid out my immediate work plan as the Secretary-General of the Securities and Exchange Commission of Thailand. The approach that I choose may look somewhat different from the previous standard operating procedures. Some may be even unconventional. My aim is simply to make them effective. From now on, I intend to concentrate instead on achieving results, which means acting early in pre-emptive fashion.

34. I very much hope that the thoughts that I shared with you tonight have raised your comfort levels about the Thai capital market a little. Hopefully enough for you to look past the current of problems of avian flu, trouble in the South. Enough to help assure your foreign colleagues of the abundant opportunities that exist here in Thailand.

Thank you for your attention