

Non-performing Loans

Non-performing loans (NPLs) in the financial system remain an important obstacle to the Thai economic recovery. NPLs represent a burden on financial institutions and a constraint on profitability because they have to be fully provisioned against. The prospect of incurring new NPLs make financial institutions very cautious about granting new loans, and has contributed towards limiting total credit growth. Moreover, rating agencies closely monitor developments in NPLs and take them into consideration in setting Thailand's overall rating.

Definition of NPLs

According to the International Monetary Fund, NPLs are defined as non-performing assets that directly affect financial institutions' balance sheets. Applying this definition to Thailand, NPLs would include all the non-performing assets in the financial system, excluding those already transferred to the Thai Asset Management Corporation (TAMC) or other asset management companies (AMCs). The latter are defined as sub-standard assets rather than NPLs.

Criteria for sub-standard asset classification

According to the new criteria announced by the BOT on 13 September 2002, sub-standard assets in the financial system can be classified into 2 parts:

1. NPLs according to the Report on NPLs, Loans to Related Parties, Fine and Summary Statement of Liabilities and Assets by each financial institution. This includes loans with principal and interest repayments that are 3 months or more overdue (time criterion). According to this classification, only the principal is counted as NPLs, and individual contracts or accounts are treated separately. For example, if a debtor has 10 accounts with principal and/or interest payments more than 3 months overdue in 7 accounts, only the 7 accounts are classified as NPLs.

2. NPLs that have been 100 per cent provisioned for. That is, uncollateralized doubtful loans that have been fully provisioned for and written off from financial institutions' balance sheets.

Previously, the BOT allowed financial institutions to write off doubtful loans that had been fully provisioned for and exclude them from reported NPL figures. In practice, however, financial institutions only really ceased their efforts to recover these loans, and thus really wrote them off, once all avenues of pursuit had been exhausted. Thus despite having written off these loans from their balance sheets, they continued to be provisioned for out of capital and added to operating costs. In this sense, these loans had a direct bearing on financial institutions' operating results as they were still actively pursued. The BOT has, therefore, required that these loans be counted as part of the official NPL figure from now on.

NPLs transferred to TAMC and state and private AMCs

Apart from the sub-standard assets already discussed above, which are counted as NPL, there are also those that have been transferred to TAMC or state and private AMCs. These are not counted as NPLs since they do not directly affect financial institutions' balance sheets. The transfer of sub-standard assets to TAMC and AMCs is an essential part of efforts to resolve the banking-sector problem, since these agencies are directly responsible for the resolution of bad loans and help to establish a clear framework for the process. Loans that are transferred to these agencies reduce the NPL figure of financial institutions.

Impact of sub-standard assets on financial institutions

Breakdown of total sub-standard assets in the system as of end-June 2002

(Millions of Baht)	Financial Institutions	TAMC	State AMC	Private AMC
Sub-standard assets	843,313	716,827	982,871	233,364
- NPL in banks and finance companies	465,914	(Transferred at 33.10	(Transferred at 79-80	(Transferred at 50-53
- NPL fully provisioned for	377,399	per cent of book value)	per cent of book value)	per cent of book value)
Progress on restructuring of sub-standard assets				
Transferred to TAMC	-	-	482,903	6,019
Successfully restructured debt and being repaid	157,055	118,369	107,113	87,799
Debt under legal execution	224,289	82,353	155,655	33,998
Debt under court progress	161,939	-	68,005	50,250
Debt under negotiation process	300,030	516,105	169,195	55,298
Total	843,313	716,827	982,871	233,364

Sub-standard assets of banks and finance companies

These assets will be classified as NPLs according to the new definition of the BOT. As of June 2002, sub-standard assets at commercial banks and finance companies stood at 843,313 million baht, of which 377,399 million baht had already been fully provisioned for. The rest was already counted as NPL under the old definition and 396,234 million baht had been provisioned for this part, which was more than the regulatory required provisioning of 255,416 million baht. The risks to profitability of financial institutions from these assets are therefore small. At the same time, negotiations over the restructuring of 300,030 million baht worth of loans were already underway, managed by the financial institutions themselves with close supervision from the BOT, and should be completed within 2 years.

Sub-standard assets of the TAMC

The TAMC was currently restructuring 516,105 million baht worth of loans. These should not further affect financial institutions since they were transferred at already substantial discounts (33 per cent of face value), while the expected recovery rate, based on operations up to now of the TAMC, was around 44 per cent. The likelihood that the TAMC would incur losses and affect financial institutions' balance sheets, through the gain-loss agreement, was therefore small. In this regard, the TAMC had adopted a framework for the resolution of these assets that emphasized returning viable enterprises to health, restructuring by sector, adding value to assets of the TAMC, as well as transparency with wide disclosure of information.

Sub-standard assets of asset management companies (AMCs)

State AMCs are currently restructuring 169,195 million baht worth of loans. As a result of the high transfer price (around 79-80 per cent of book value), they have incurred substantial losses, both from those transferred to the TAMC as well as those that they restructured themselves. However, the authorities had already adopted measures to deal with this problem, namely the issuance of government bonds to finance the losses of the Financial Institutions Development Fund (FIDF) from these assets, estimated to be around 650,750 million baht. Thus in the event that only a small proportion of the loans are successfully restructured, the impact on the financial system should not be very large.

Private AMCs are managing a relative small amount of loans, amounting to around 55,298 million baht. The expected recovery rate on these loans is good and thus should not adversely affect profitability of financial institutions. On the contrary, they could potentially boost profits.

Conclusion

It is clear that sub-standard assets in the system, spread out as they were in a number of places, have been considered by the authorities and a transparent framework for their resolution put in place. These assets, therefore, should not cause further damage to financial institutions' balance sheets. At the same time, the continued recovery of the Thai economy has put sub-standard assets on a downward trend.