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Thailand: Bond Stabilization Fund¹

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Yale Program on Financial Stability Case Study

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Abstract

Early in the COVID-19 crisis, non-financial businesses grew concerned that they would be unable to roll over their maturing bonds. To calm corporate debt markets, the Bank of Thailand (BOT) announced the Bond Stabilization Fund (BSF) on March 22, 2020. The BSF planned to purchase newly issued commercial paper from viable companies that could not roll over their maturing bonds. However, the program was not used. The BOT, seeking to avoid public criticism for directly supporting large corporations, imposed restrictions that made the program less attractive to borrowers. The main deterrent to participation was the requirement that borrowers must have already secured at least 50% of their funding needs from other sources. The BSF also charged a penalty rate that increased as its involvement increased. Last, participants could not, for the duration of the bond, buy back their stock, repay other debts early, pay bonuses, or distribute dividends. The BSF stopped accepting applications from participants at the end of 2022.

Keywords: backstop, BSF, COVID-19 pandemic, market liquidity, short-term debt, Thailand

¹ This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering market support programs in response to COVID-19. Cases are available from the *Journal of Financial Crises* at <https://elischolar.library.yale.edu/journal-of-financial-crises/>.

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Overview

The economic uncertainty and panicked atmosphere of the COVID-19 crisis caused investors to sell corporate bonds to raise cash. The Bank of Thailand (BOT) worried about companies “that cannot fully rollover maturing corporate bonds” (BOT, MOF, and SEC 2020). The BOT deployed several measures to contain stress in financial markets. On March 22, 2020, the BOT announced the Bond Stabilization Fund (BSF) to purchase newly issued short-term debt (commercial paper) from investment-grade Thai issuers that faced difficulty rolling over long-term debt. On the same day, the government also announced a government-bond purchase program and a lending facility for mutual funds.

The BOT set up the BSF as a mutual fund owned by the BOT and managed by Krung Thai Asset Management, which was also owned by a subsidiary of the BOT. Investment-grade corporate bond issuers could apply to the BSF. Applicants presented the BSF’s investment manager with proof that they had secured financing from banks and corporate bond markets equivalent to at least half the value of their bonds maturing from 2020 to 2021. If accepted, the BSF would then buy commercial paper to fund the applicant’s redemption of its maturing bonds. The use of commercial paper insulated the BOT from the exposure that longer-term bonds could have created. It would also be easier for the BOT to wind down its involvement had signs of trouble emerged in participants’ finances. An emergency decree formally established the BSF on April 19, 2020, about a month after its announcement (Vajiralongkorn 2020). According to sources familiar with the BSF, the BOT was wary of the reputational damage and financial risk of lending to Thailand’s largest businesses. BOT lending had been controversial since the bailouts of dozens of finance companies in the Asian Financial Crisis saddled the Thai government with substantial losses and debt that was still outstanding in 2020. The BSF set onerous terms that reflected the BOT’s reluctance to enter the corporate debt market, as shown in Figure 1. To secure financing, an issuer’s bank loans and bond subscriptions must have each provided at least 20% of the funds needed, and at least 50% of the funding needs had to be first covered by private sources

Key Terms

Purpose: To backstop companies that could not “fully rollover maturing corporate bonds” (BOT, MOF, and SEC 2020)

Launch Dates	Announced: March 22, 2020 Authorized: April 19, 2020
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Operational Dates	SPV established: April 19, 2020 First accepted applications: April 29, 2020
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End Date	Last application to be accepted by December 31, 2022
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Legal Authority	Emergency Decree B.E. 2563
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Source(s) of Funding	Originally public-sector enterprises, insurance providers, and the Thai Bankers Association; ultimately BOT
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Administrators	Krung Thai Asset Management
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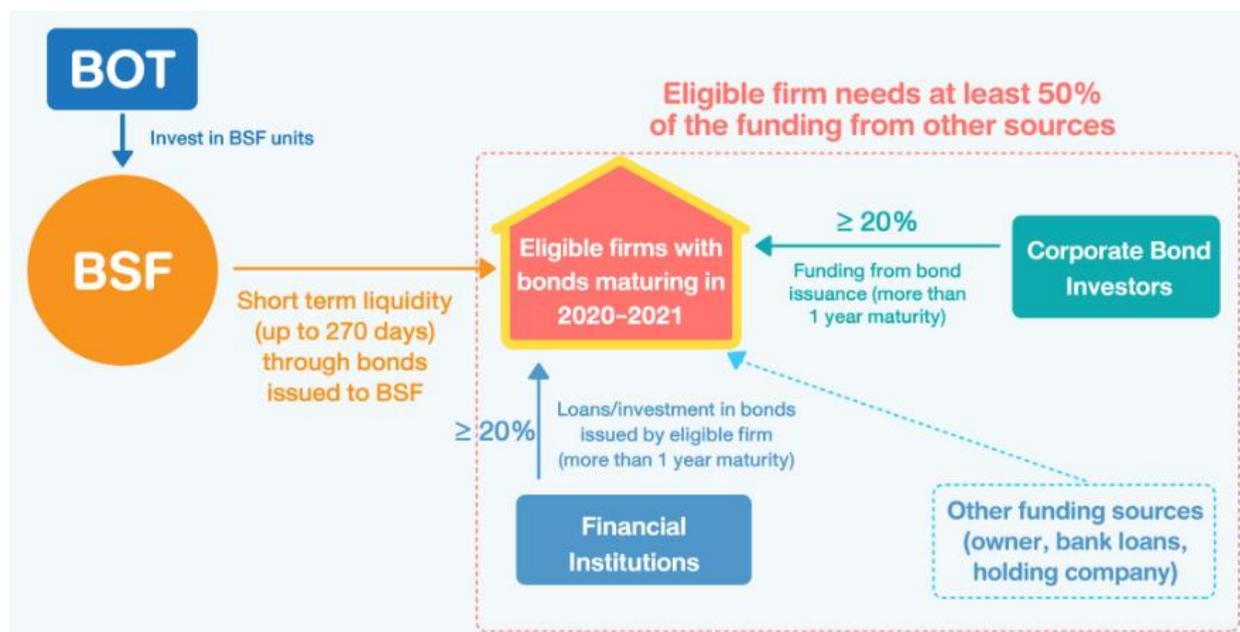
Overall Size	THB 400 billion
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Purchased Assets	Newly issued commercial paper
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Peak Utilization	<i>Not used</i>
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for issuers to access BSF. Issuers had the option of raising new capital from shareholders. The BSF also required participants to obtain commitments of financial support from their major creditor for the duration of BSF financing (BOT 2020). This approach relied on private creditors and investors to evaluate participants' creditworthiness. BOT staff said it worked because of the unusually close relationships that Thai firms had with their banks. The BOT cited a lesson of Thailand's recapitalization program from the Asian Financial Crisis for the choice to follow private market intelligence.

Figure 1: Funding Requirements for BSF Investment



Source: BOT 2020, 2.

The BSF also imposed behavioral restrictions on participants. During the term of BSF support, participants could not engage in stock buybacks, distribute dividends, or pay executives bonuses (BOT 2020, 6).

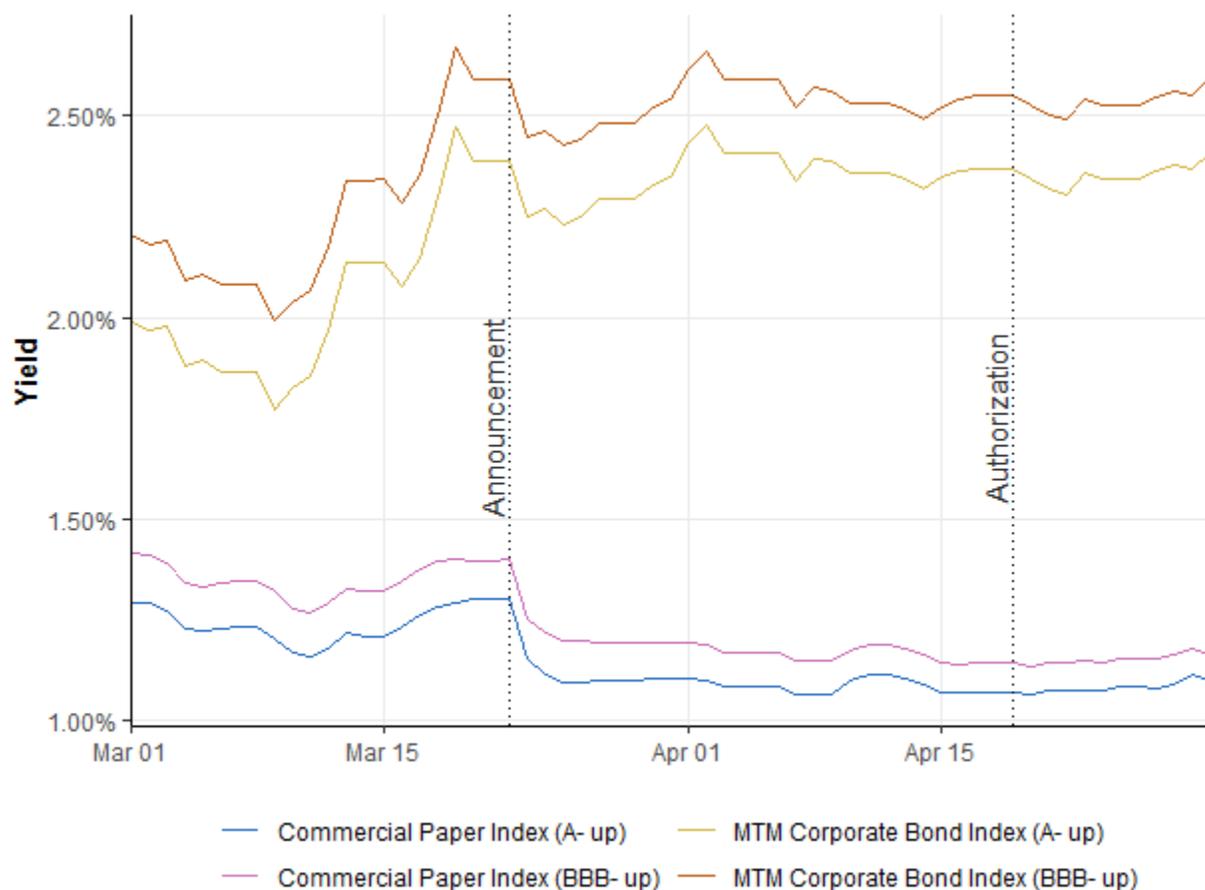
The original announcement set the BSF at THB 70 billion–THB 100 billion (USD 2.2 billion to USD 3.2 billion);³ it was later capped at THB 400 billion. However, as of October 2021, the BSF had not been used. News reports noted that many companies were able to roll over their existing debts rather than use the facility (Chudasri 2020). BOT said that firms applied to the BSF but ultimately received full funding from their banks, eliminating the need for the facility. The program's formal end date was ambiguous: although the decree authorizing the facility required it to remain operational until 2025, the BSF did not accept debt that matured after December 31, 2022 (BOT 2020, 4).

³ USD 1 = THB 31.5 during March 2020.

Summary Evaluation

As of publication, there has been no formal evaluation of the BSF either by the BOT or academics. BOT staff took the subsequent fall in corporate bond yields, depicted in Figure 2, as an indication of the program's announcement effect. Shortly after the BOT released technical documents detailing the BSF, former BOT officials spoke against the facility; one said that the central bank "should not play a role as a banker for companies and judge which companies deserve assistance" (Polkuamdee, Banchongduang, and Chudasri 2020). Current staff also said that the purpose of the BSF was only to calm markets and that usage was not necessary. In its 2020 annual report, the BOT noted that although no businesses ultimately required assistance from the BSF, the measure succeeded at restoring market confidence and protecting financial stability (BOT 2021, 46).

Figure 2: Commercial Paper and Corporate Bond Index Rates



Sources: TBMA 2020a; TBMA 2020b.

Context: Thailand 2019–2020	
GDP (SAAR, nominal GDP in LCU converted to USD)	\$544.5 billion in 2019 \$502.5 billion in 2020
GDP per capita (SAAR, nominal GDP in LCU converted to USD)	\$7,817 in 2019 \$7,187 in 2020
Sovereign credit rating (five-year senior debt)	Data for 2019: Moody's: Baa1 S&P: A- Fitch: BBB+ Data for 2020: Moody's: Baa1 S&P: A- Fitch: BBB+
Size of banking system	\$677.1 billion in 2019 \$727.6 billion in 2020
Size of banking system as a percentage of GDP	124.4% in 2019 144.3% in 2020
Size of banking system as a percentage of financial system	70.2% in 2019 70.8% in 2020
Five-bank concentration of banking system	75.0% in 2019 86.5% in 2020
Foreign involvement in banking system	Data not available for 2019 Data not available for 2020
Government ownership of banking system	Data not available for 2019 Data not available for 2020
Existence of deposit insurance	\$160,500 in 2019 \$160,500 in 2020
<i>Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.</i>	

Key Design Decisions

1. Purpose: The BSF aimed to provide corporate bond issuers with a lender of last resort for maturing debt.

The Bank of Thailand, Ministry of Finance (MOF), and Securities and Exchange Commission (SEC) announced that the BSF's purpose was to "invest" in eligible debt (BOT, MOF, and SEC 2020). However, the restrictive terms of the BSF limited the risks the BOT could take on and the pool of eligible participants. BOT staff had recognized that they were under public pressure to intervene in corporate debt markets, but they were reluctant to lend directly to large corporations. They did not want companies to use BOT funding too easily or unnecessarily. Their intention was, rather, to calm corporate debt markets and show that the BOT stood by as a liquidity backstop but did not support long-term borrowing.

2. Part of a Package: The BSF joined two other emergency programs aimed at financial markets.

The BSF was announced alongside two other programs to ease stress in markets. One program purchased government bonds, while the other provided liquidity to commercial banks that, in turn, invested in high-quality money market mutual funds.⁴ The government also announced a THB 500 billion program to lend to small- and medium-sized enterprises (SMEs), and a THB 100 billion fund to allow SMEs to defer debt payments at low interest rates for up to six months (Paweeun 2020). Earlier in March 2020, the BOT announced a cut to its main policy rate.

3. Legal Authority: An emergency decree authorized the BOT to hold shares in the BSF.

The King of Thailand issued an emergency decree on April 18, 2020, creating the BSF, specifying its organizational structure, and naming the BOT as sole shareholder. The BOT was not usually allowed to hold ownership stakes in corporations, with the exception of shares obtained as collateral (Bank of Thailand Act 2018, sec. 9).

4. Governance: The Steering Committee and the Investment Committee governed the BSF.

The Steering Committee (SC) was headed by the Permanent Secretary of the Ministry of Finance and included the BOT governor, the director generals of the Public Debt Management Office (PDMO) and Fiscal Policy Office, and three external experts (BOT 2020, 3). The SC supervised the Investment Committee (IC), guided investment and risk management, and selected Krung Thai Asset Management (KTAM) as the asset management company. The Investment Committee was headed by the BOT's Deputy Governor of

⁴ Ten financial institutions borrowed from the mutual fund liquidity program during 2020, with total outstanding peaking at THB 56 billion (BOT 2021, 27).

Monetary Stability and included one official each from the PDMO and Government Pension Fund, and two external experts. The IC formulated investment strategy according to the SC, soliciting any advisors for help (BOT 2020, 3).

Every month, the IC reported its performance to the SC. BSF governance also included an advisor, a trustee (Bangkok Bank), and an auditor (Ernst and Young, also known as EY) (BOT n.d.; BOT 2020, 3).

5. Administration: Krung Thai Asset Management, an asset manager owned by the BOT, invested BSF funds and monitored its performance.

The BSF retained Krung Thai Asset Management as its asset manager. KTAM carried out the investment strategy decided by the BSF's two governing committees and monitored the outlook of the BSF's investments (BOT 2020, 3). The BOT owned KTAM and its parent, Krung Thai Bank, through a subsidiary of the BOT known as the Financial Institutions Development Fund (SEC 2019).

6. Communication: Official communication about the BSF was scarce.

The BSF was announced on March 22, 2020, by a joint press release of the BOT, Securities and Exchange Commission, and Ministry of Finance. This press release said that the BSF's purpose was "to invest in high-quality, newly issued bonds by corporates that cannot fully rollover maturing corporate bonds" (BOT, MOF, and SEC 2020). The press release did not position the BSF as a backstop to the market or mention the BOT's reluctance to engage with corporate borrowers. Later, the BOT released the fund's terms and conditions (BOT 2020). Krung Thai Asset Management also published technical circulars in Thai, such as questions and answers that mostly focused on how to calculate and document an issuer's needs.

7. Disclosure: KTAM was required to report the fund's performance monthly.

KTAM was required to report the fund's performance on its website on the first business day of each month (BOT 2020, 7).

8. Use of SPV: The BOT established the BSF as a mutual fund.

The emergency decree specified that the BSF would be a mutual fund incorporated to provide liquidity to private debtors and that the BOT would be its sole shareholder initially (Vajiralongkorn 2020, 2–3).

9. Size: The original announcement set the BSF at THB 70 billion–THB 100 billion; it was later capped at THB 400 billion.

The March 22 press release said that the program would be THB 70–THB 100 billion. The April 18 emergency decree capped its size at THB 400 billion (Vajiralongkorn 2020, 3). That cap was 40% of Thailand's annual commercial paper issuance, a similar amount of its annual corporate bond issuance, and about 10% of total outstanding corporate bonds.

To manage its exposure, the BSF limited individual investments to 3% of the fund for a single issuer and 10% of the fund for a single business conglomerate. Since the BSF set its fund size at THB 400 billion, those limits apparently would be THB 12 billion and THB 40 billion, respectively. The BSF also could not buy more than 10% of an issuer's total financial liabilities.

10. Source(s) of Funding: The BOT originally announced that various public and private organizations would provide funding but later funded the program itself with an indemnity from the Ministry of Finance to protect it from losses.

The BSF received THB 1 billion in start-up funding from the BOT. The emergency decree stipulated that any profits generated would flow to the Ministry of Finance. The Ministry of Finance would have indemnified the BOT up to THB 40 billion for any losses (Vajiralongkorn 2020, sec. 20).

When the BOT originally announced the BSF, it said that funding would come from two public financial corporations (the Government Savings Bank and Government Pension Fund), unnamed insurance companies, and the Thai Bankers' Association, a professional association representing domestic banks (BOT, MOF, and SEC 2020). However, this plan was abandoned before implemented.

The BSF managed its liquidity by investing in savings accounts or other low-risk assets as chosen by the IC.

11. Eligible Institutions: Investment-grade and illiquid but viable Thai corporations that had already secured at least 50% of the value of their maturing bonds from private parties were eligible to issue new commercial paper to the BSF.

Participants in the BSF must have been illiquid but viable privately owned corporations. State-owned corporations and financial institutions and companies under the same group were not eligible. Applicants were required to specify a plan for future financing to prove viability after COVID-19 and demonstrate an investment-grade rating at least one month prior to their application to prove they were viable before COVID-19. If ratings agencies disagreed, the BOT used the lowest rating, further restricting the pool of eligible applicants. Applicants must also have been registered and operating in Thailand.

The BSF also required corporate borrowers to seek private funding before participating in the program. At least 20% of financing for a firm's maturing bonds must have already been secured from banks, another 20% from further bond issuance. In total, the applicant must have secured at least 50% of its maturing bonds from private sources. If banks and bond issuers were unable to meet 50% of needs, then a firm's ownership could inject capital to meet the difference. Figure 1 depicts these requirements. The firm's major creditor, usually a bank, was required to send the BSF a letter committing it to support the company financially during the duration of the loan (BOT 2020, 4). This design relied on Thailand's banks as institutions capable of and interested in evaluating a borrower's creditworthiness. It also further removed the BSF and, by association, the BOT from deciding to which borrowers it would lend.

12. Auction or Standing Facility: The BSF was a standing facility that participants could access by submitting applications.

Firms must have applied for BSF liquidity no less than 45 days before the date their bonds matured, with all documents submitted no more than 15 days after the application date. The IC would then decide whether to support an applicant (BOT 2020, 8).

13. Loan or Purchase: The BSF planned to purchase commercial paper outright.

If the BSF were used, it would have purchased commercial paper directly from the issuers (BOT, MOF, and SEC 2020). It is unclear whether it would have held such debt to maturity or sold it in the secondary market.

14. Eligible Assets: The BSF planned to issue commercial paper to allow companies to pay off maturing bonds that they had issued before April 19, 2020, and that matured by December 31, 2022.

The BSF's English-language documents did not describe precisely which securities it would accept. Program documents mentioned investment-grade senior plain vanilla debt and non-subordinated bonds with tenor less than 270 days, which suggests that the BSF planned to purchase newly issued commercial paper, although the term is never used (BOT 2020, 4).

Participating companies could use the proceeds of the commercial paper and privately issued debt to pay off maturing bonds that they had issued before the BSF's establishment on April 19, 2020, and that matured by December 31, 2022. They could not use the proceeds for any other purpose. If the private funding that a company received was secured, the BSF expected to receive similar collateral for its bonds. The BSF would not purchase debt intended to replace private-placement bonds (BOT 2020, 4).

The decree that created the BSF allowed it to purchase debt on the secondary market, though no other documents mention this feature (Vajiralongkorn 2020).

15. Purchase Price: The BSF would have charged firms a base rate equal to the highest private rate plus a premium that increased with facility usage.

Successful applicants would have paid the BSF a base rate plus a facility premium. The base rate was equal to the maximum of the rate on its new bank loan and the rate on new bonds it issued on the market. The facility premium was equal to 100 basis points (bps) for short-term debt equivalent to 30% of the issuer's funding needs and 200 bps for any amount exceeding 30% of the funding needs (BOT 2020, 5).

16. Haircuts: As an asset purchase program, the BSF did not feature haircuts.

No haircuts were applied because the BSF did not engage in lending.

17. Interest Rates: As an asset purchase program, the BSF did not specify interest rates.

The BSF did not specify interest rates because it did not engage in lending.

18. Fees: The BOT would not have charged any fees to issuers who participated in the BSF.

No documents suggest that the BOT would have charged other fees to participants.

19. Term/Repayment: Participants could repay their debts early.

The BSF allowed participants to repay their debt before the indicated maturity date if they notified the BSF at least five days in advance (BOT 2020, 8).

20. Other Restrictions on Eligible Participants: Participants faced behavioral restrictions until short-term debt matured and could not take out new debt.

BSF participants were prohibited from several activities and disbursements while the securities sold to the BSF remained outstanding. The BOT would enforce these conditions by requiring participants to submit reports to the BOT. The first condition was double-listed: participants could use BSF funds only to pay off existing maturing bonds and could not use funds to reduce capital. Participants could also not, during the term of the loan, engage in stock buybacks, repay non-BSF debt early, lend or pay dividends to shareholders, give bonuses to board members or the firm's top two executives, or pledge assets as collateral for new loans (BOT 2020, 6).

21. Regulatory Relief: Participants would have received no regulatory relief when participating in the BSF.

No documents suggest that firms or lending banks would have received relief from capital or liquidity regulations because of participating in the BSF.

22. International Coordination: The BOT did not coordinate with entities outside Thailand to administer the BSF.

No such programs appear connected to the BSF.

23. Duration: The BSF application window closed December 31, 2022, but documents indicate other possible end dates for the BSF itself.

The BSF stopped accepting applications on December 31, 2022, the last date that eligible debt securities could mature. Its original plan allowed for an early end date if it counted THB 400 billion outstanding, limiting the BOT's potential exposure (BOT 2020, 8). The decree that established the BSF allowed the facility to stay active for five years, but this duration was subject to an extension by Steering Committee vote. Had the BSF been used, the short

maturities of the debt it purchased would have allowed it to wind down its exposure quickly rather than hold corporate bonds with maturities longer than a year.

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