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Thailand: FIDF Blanket Guarantee, 1997[1]

Ayodeji George[2]

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Abstract

The Thai government's decision to allow the baht to float in July 1997 was the pivotal event of the Asian Financial Crisis. The baht fell 20% by the end of the month, further pressuring Thai financial institutions that had borrowed heavily in US dollars and other foreign currencies. In early August, Thailand's Finance Minister and the Bank of Thailand (BOT) announced the suspension and restructuring of insolvent finance companies and a blanket guarantee covering depositors and creditors of all domestic banks and the remaining finance companies, administered by the BOT's Financial Institutions Development Fund (FIDF). However, the blanket guarantee was initially unsuccessful in restoring public confidence because of early inconsistencies in messaging and skepticism about the credibility of the guarantee given the extent of financial institutions' liabilities. Bank runs continued for months after the government announced the guarantee and ended only in November, when the government began to use its new authority to take over insolvent banks and assume their liabilities, rather than closing them and directly paying guaranteed depositors and creditors. No guaranteed depositors or creditors lost money after the government announced the blanket guarantee. The FIDF ultimately lost THB 1.4 trillion (USD 34 billion) in bailing out guaranteed banks and finance companies, THB 554 billion of which specifically went toward the blanket guarantee. In 2003, the FIDF reduced the blanket guarantee's coverage to include only depositors and no other creditors. The blanket guarantee ended with the enactment of the Deposit Protection Agency Act in 2008, which established a limited deposit insurance scheme that protected deposits up to THB 1 million (USD 32,000).

Keywords: Asian Financial Crisis, blanket guarantee, FIDF, Thailand

[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering blanket guarantee programs. Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

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Overview

Thailand and other Southeast Asian countries experienced an economic boom in the early 1990s (Corsetti et al 1999). Thai financial institutions borrowed liberally from foreign sources, largely in US dollars, to finance extensive real estate lending. Thailand's current-account deficit peaked at 8.5% of its GDP in 1996. This made Thailand particularly vulnerable to speculative attacks on its currency (Haksar and Giorgianni 2000; Sharma 2013).

In 1996, growing numbers of real estate borrowers began to default on their loans, pressuring Thai financial institutions. The Bangkok Bank of Commerce (BBC), Thailand's ninth-largest bank, collapsed on May 10, 1996. This led to the first of many speculative foreign currency attacks that year (Sharma 2013).

The BOT expended significant resources throughout 1996 and 1997 to defend the baht (Sharma 2013). On June 25, 1997, the finance minister announced that the government no longer had the necessary reserves to continue to defend its currency. On the same day, news reports revealed that the government had abandoned its efforts to support the country's largest finance company, Finance One (Corsetti et al 1999).

On June 26, 1997, the BOT issued 30-day suspensions, or orders to cease operations, to 16 finance companies (including Finance One) on the basis of their impaired capital and limited liquidity (Sharma 2013). The measure failed to stop depositor runs on other finance companies and small banks, in part because the Financial Institutions Development Fund (FIDF), a body within the BOT concerned with financial health, did not protect depositors and creditors of the suspended companies. Rather, it exchanged their deposits for promissory notes issued by a state-owned finance company and allowed other creditors to incur substantial losses (Santiprabhob 2003). Meanwhile, on July 2, 1997, the government allowed the baht to float (IMF 1997a).

Key Terms

Purpose: To resolve "the crisis of confidence" among depositors and creditors (FIDF 1997)	
Launch Dates	Authorization: August 5, 1997; Announcement: August 5, 1997
End Date(s)	February 6, 2008
Eligible Institutions	All non-suspended banks, finance companies, and foreign bank branches
Eligible Liabilities	All depositors and creditors except subordinated debt holders and off-balance-sheet creditors
Fees	0.3-0.4% of covered liabilities
Coverage	THB 10.6 trillion
Outcomes	No depositors lost money; the FIDF ultimately lost THB 1.4 trillion in bailing out covered financial institutions, THB 554 billion of which helped depositors
Notable Features	The guarantee covered principal and interest using local currency, but set caps on the interest rates

The currency depreciated 20% by the end of July. Both the finance minister and central bank governor resigned, and the government formally requested support from the International Monetary Fund (IMF) on July 28, 1997 (Boughton 2012; Nabi and Shivakumar 2001).

The new central bank governor promised a blanket guarantee of the principal and interest for depositors and creditors of all finance companies on August 5, 1997. The guarantee came with the suspension of an additional 42 troubled finance companies, bringing the total number of suspended firms to 58 (Koetsawang 1997). The central bank governor assured that the guarantee was "no lip service" in his August 5 press conference (Dow Jones Newswires 1997). As such, the board of the FIDF rescinded a previous guarantee on promissory notes that it had extended to 10 specific banks (Ingsrisawang 1997). The central bank governor reiterated the government's commitment to depositors on August 6, urging the public not to panic (Miller 1997). The assistant bank governor attributed the extension of the blanket guarantee to discomfort within the central bank with the amount of Thai deposits being transferred to foreign banks. The amount of withdrawals was reported by the government to be between THB 15 billion and THB 20 billion per week (McDowell 1997).

On August 7, 1997, the Ministry of Finance announced a blanket guarantee for creditors and depositors in all banks and the 33 remaining non-suspended finance companies (Government of Thailand 1997). The guarantee, which the Bank of Thailand Act (BOT Act) gave the FIDF the power to administer, was extended to assure the public of the solvency of financial institutions and increase confidence in the stability of the financial system by protecting depositors and creditors of financial institutions. However, the original guarantee outlined on August 7, 1997, did not specify the exact liabilities covered, leading to confusion and doubt among the public about the government's ability and willingness to honor the guarantee (FIDF 1997; Nabi and Shivakumar 2001).

Later in August, the IMF agreed to a three-year standby loan agreement worth 2.9 billion special drawing rights (SDR; about USD 3.9 billion) (IMF 1997b). The blanket guarantee was a key commitment from the Thai government in exchange for the loan agreement (Government of Thailand 1997).

Depositors and creditors of the 42 institutions suspended in August 1997, as well as depositors in finance companies suspended in June 1997, were given the option of exchanging their claims for fully guaranteed notes from the state-owned banks Krung Thai Thanakit (KTT) and Krung Thai Bank (KTB) (Minister of Finance and BOT 1997). The FIDF was responsible for payment of both principal and interest on guaranteed notes (Nabi and Shivakumar 2001). However, the FIDF capped the amount of interest it would cover to discourage banks from using the guarantee to compete for deposits with high rates (FIDF 1997). Figure 1 details the different forms of protection and the financial institutions which it covered.

Figure 1: Coverage by Institution Type

Financial Institution Status	**Type of Coverage**
Institutions suspended on June 16, 1997	Depositors eligible for note exchange scheme; creditors not covered
Institutions suspended on August 5, 1997	Depositors and creditors eligible for note exchange scheme
Remaining institutions	Depositors and creditors covered by FIDF blanket guarantee

Source: Author's analysis.

Runs continued on small banks and finance companies despite the announcement of the blanket guarantee (Santiprabhob 2003). A government decree on October 25, 1997, amended the BOT Act to allow the FIDF to draw funds directly from the government. The decree specified depositors and creditors that were eligible for the blanket guarantee. The guarantee did not cover subordinated debt holders, off-balance-sheet creditors, and shareholders' funds (Emergency Decree B.E. 2485 1997; Government of Thailand 1997, box 1).

The October legislation created a new agency to take control of insolvent financial institutions and assume their liabilities (Emergency Decree B.E. 2540 1997). Under the previous laws, the FIDF's only option was to liquidate a financial institution and directly pay guaranteed depositors and creditors. With the new legislation, the FIDF could avoid such direct payouts by taking over an institution, reselling it or merging it with another institution, and using government resources to fill any gap between the value of its assets and the liabilities owed to depositors and other guaranteed creditors. The FIDF's first such intervention was in the Bangkok Metropolitan Bank (BMB), the ninth-largest bank at that time, in November 1997:

> That intervention was a major shift in approach from the previous method of suspending and closing insolvent FIs. Under the intervention approach, the bank, pending a decision on its future, was allowed to service its depositors and debtors as normal, thereby minimizing the impact on the real economy and preventing the government from compensating depositors and creditors outright under the blanket guarantee. (Santiprabhob 2003, 17)

The government thus avoided paying depositors directly under the blanket guarantee by taking control of insolvent financial institutions. The FIDF incurred significant expenses from its various crisis responses, accumulating THB 1.4 trillion in debt (USD 34 billion) to cover losses.[3] Of this total, THB 554.1 billion was specifically used to help guaranteed depositors

[3] In June 2002, USD 1 was equivalent to THB 41.58 (per Federal Reserve).

(BOT n.d.a; BOT n.d.b). By 2015, the FIDF was liable for approximately THB 1 trillion of this debt (Sangwongwanich 2015).

Though no end date was set for the blanket guarantee, the IMF rescue package included a stated goal of creating a more limited deposit insurance program once the economic situation had stabilized and the system had been restructured. Authorities said in 1999 that they would try to incentivize banks and other finance companies to exit the guarantee by making it voluntary, but they ultimately never made that change. Rather, in 2003, the FIDF reduced the blanket guarantee's coverage to include only depositors and not creditors. The FIDF guarantee officially ended when the Deposit Protection Agency Act, enacted on February 6, 2008, installed a limited deposit insurance program that covered deposits up to THB 1 million (about USD 31,817)[4] (BOT n.d.b; Deposit Protection Agency Act 2008).

Summary Evaluation

The Thai government enacted the FIDF guarantee to restore public confidence in the soundness of the financial system following the suspension of 58 of its 91 finance companies (FIDF 1997; Government of Thailand 1997). A 2001 World Bank report concluded that the guarantee and other government measures were unsuccessful in this task, as market confidence continued to deteriorate into 1998. The Thai government struggled to restore public confidence because of the size of liabilities the program covered and inconsistencies in government messaging. Limited deposit runs continued even after the announcement of the blanket guarantee. The mechanism for funding and executing the guarantee as well as handling suspended institutions was also unclear. It took considerable time to establish the framework for handling suspended institutions because of the slow progress of parliamentary measures (Nabi and Shivakumar 2001; Santiprabhob 2003).

The public viewed the government's June 1997 announcement about the first 16 finance company suspensions as non-transparent, according to Veerathai Santiprabhob, an IMF official during the crisis who later became the central bank governor. He said in a 2003 paper that the BOT did not publicly disclose the criteria used to decide which institutions were suspended, leading to skepticism over the strength of the institutions that remained. The August suspension was more successful in slowing deposit runs among the remaining financial institutions because the government announced the blanket guarantee in the same announcement and because it said it would protect some types of creditors of suspended institutions that it had not protected in the first round of suspensions (Santiprabhob 2003).

The Bangkok Post reported a major policy reversal on August 5, 1997, in which the government rescinded its original promise to guarantee promissory notes issued by 10 weak finance firms. This policy change followed changes in the leadership of both the BOT and MOF (Ingsrisawang 1997).

Only with the legislation of October 1997 did the government have the authority to take over and resolve insolvent financial institutions, rather than closing them and directly paying

[4] In February 2008, USD 1 was equivalent to THB 31.43 (per Federal Reserve).

guaranteed depositors and creditors. In November 1997, the BOT used that authority to take control of the Bangkok Metropolitan Bank (BMB) after it showed signs of weakness. Rather than suspend the bank's operations, Thai authorities allowed the bank to continue to service its depositors and creditors. This demonstration of their ability to intervene without hurting depositors helped stop the deposit runs and strengthened the public's confidence in the blanket guarantee. Santiprabhob suggests that if this intervention approach had been instituted alongside the blanket guarantee sooner, it could have lessened the severity of the crisis. The World Bank report suggested that a royal decree would have accelerated the process but may also have triggered a parliamentary vote of no confidence given the fragile political climate (Nabi and Shivakumar 2001; Santiprabhob 2003).

Context: Thailand 1997–1998		
GDP (SAAR, nominal GDP in LCU converted to USD)		$150.2 billion in 1997
		$113.7 billion in 1998
GDP per capita (SAAR, nominal GDP in LCU converted to USD)		$2,468 in 1997
		$1,846 in 1998
Sovereign credit rating (five-year senior debt)	1997	Moody's: Data not available
		S&P: A
		Fitch: Data not available
	1998	Moody's: Baa1
		S&P: A-
		Fitch: BBB+
Size of banking system		$257.4 billion in 1997
		$185.6 billion in 1998
Size of banking system as a % of GDP		171.4% in 1997
		163.3% in 1998
Size of banking system as a % of financial system		Data not available in 1997
		Data not available in 1998
Five-bank concentration of banking system		Data not available in 1997
		Data not available in 1998
Foreign involvement in banking system		Data not available in 1997
		Data not available in 1998
Existence of deposit insurance		No in 1997
		No in 1998
Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.		

Key Design Decisions

1. **Purpose: Thai authorities extended the blanket guarantee to assure the public about the soundness of commercial banks and remaining finance companies when it closed 58 troubled finance companies.**

The BOT suspended 16 finance companies in June 1997 and 42 more in August 1997. At the time of the second suspension, Thai authorities extended a blanket guarantee to depositors and creditors of all banks and the remaining finance companies to assure the public about the soundness of the rest of the financial system (FIDF 1997). Thai depositors were continuously transferring funds into larger institutions and foreign banks during this period. Thai authorities feared that this flight to quality would cause otherwise healthy finance companies to become unstable. At the time the guarantee was announced, the government reported that weekly withdrawals totaled between THB 15 billion and THB 20 billion per week (McDowell 1997; Sherer 1997).

2. **Part of a Package: The guarantee was released as one piece of a broader IMF-backed effort to restore stability to the Thai financial system.**

The Thai government announced that it was pursuing an IMF agreement on July 28, 1997, following the resignation of the central bank governor and finance minister. The new central bank governor announced the blanket guarantee for depositors and creditors on August 5, 1997, alongside the announcement by the new finance minister of the suspension of 42 finance companies (Boughton 2012; Dow Jones Newswires 1997).

In an August 14, 1997, letter of intent to the IMF, the Thai government committed to a Financial Restructuring Program to restore public confidence in the financial system. The blanket guarantee was a central part of that program. The program also included the isolation of the weakest institutions, through suspension and restructuring; an institutional framework for restructuring the financial system; and reforms to improve the efficiency, profitability, and solvency of the system. The IMF approved the rescue package on August 20, 1997. The package also included fiscal, monetary, and exchange rate policies intended to prevent the flow of capital out of the country and establish a fiscal surplus (Government of Thailand 1997; Nabi and Shivakumar 2001).

3. **Legal Authority: The Prime Minister signed emergency decrees giving the BOT the power to take over and restructure insolvent financial institutions and amending the Bank of Thailand Act to enable the FIDF to draw funds directly from the government to fully guarantee depositors and creditors.**

The BOT Act established the FIDF to reconstruct and develop the financial system to accord it strength and stability. From the original passing of the BOT Act, the FIDF had the legal authority to extend guarantees with the condition of charging all covered institutions a fee (BOT 2018, ch. 5). On October 22, Thailand's prime minister signed an emergency decree amending the Bank of Thailand Act. The decree, which Parliament passed a few days later, empowered the FIDF to draw funds directly from the government, giving more credibility to the blanket guarantee (Emergency Decree B.E. 2485 1997; Nabi and Shivakumar 2001).

Also on October 22, the Emergency Decree on Financial Sector Restructuring established the framework for handling suspended institutions (Emergency Decree B.E. 2540 1997). The prime minister signed a decree amending the Commercial Banking and Finance Companies Acts to provide new legal powers to the BOT (Emergency Decree B.E. 2505 1997). The amendments gave the BOT more control over financial institutions to change their management. It also empowered the BOT to write down the value of closed institutions' shares in order to protect depositors and creditors (FIDF 1997; Government of Thailand 1997, box 1; Sutham 1997).

4. Administration: The FIDF administered the guarantee.

The FIDF administered the guarantee. The BOT Act empowered the FIDF to administer guarantees (BOT 2018, ch. 5). The program did not require any form of application and the eligible liabilities of all remaining institutions were immediately covered in full (FIDF 1997).[5]

5. Governance: The Finance Minister appointed the committee that oversaw the FIDF.

A five-to-nine-member Fund Management Committee oversaw the FIDF. The finance minister appointed the members of this committee. The governor of the BOT served as the chairman of the committee, and the committee appointed an officer of the BOT to serve as the manager of the FIDF. The FIDF's accounts were audited annually by the Office of the Auditor-General. The auditor presented an audit report to the Finance Minister and sent a copy to the BOT (BOT 2018, ch. 5).

The Finance Minister, BOT, and Fund Management Committee established a set of criteria to monitor quantitative performance, indicative targets, and structural performance of financial institutions in order to monitor the effectiveness of the Financial Restructuring Program (Government of Thailand 1997).

The BOT and Minister of Finance resolved to improve transparency to help market participants make informed economic decisions. Starting on August 29, 1997, the BOT committed to publishing data on the key elements of its assets and liabilities on a fortnightly basis. The BOT also worked closely with financial institutions and regulatory bodies to ensure the publishing of "regular and comprehensive data on their financial condition." Finally, the BOT and Finance Minister reviewed the FIDF's Special Dissemination Standards to achieve greater efficiency and transparency (Government of Thailand 1997).

[5] The KTT and KTB oversaw the note exchange scheme for eligible claimants in suspended institutions. The FIDF was responsible for compensation of all depositors and creditors (Nabi and Shivakumar 2001).

6. Communication: The Bank of Thailand said that the guarantee was meant to restore confidence in the financial system.

On July 28, 1997, the Thai government announced that it was seeking support from the IMF (Nabi and Shivakumar 2001). The central bank governor assured that depositors and creditors would be protected during a press conference on August 5 (Dow Jones Newswires 1997). The Finance Minister officially announced the blanket guarantee on paper on August 7, 1997 (FIDF 1997). On August 14, 1997, Thailand submitted a letter of intent to the IMF detailing its plan for crisis response, of which the blanket guarantee was a part (Government of Thailand 1997). On August 20, 1997, the IMF officially announced the three-year standby loan agreement extended to Thailand (IMF 1997b).

The public did not respond as intended to the communication of the blanket guarantee, and market confidence continued to falter. The public was not entirely certain of the extent of guarantees and which liabilities were covered. This led to a lack of confidence in the credibility of the blanket guarantee (Nabi and Shivakumar 2001; Sharma 2013).

7. Source(s) and Size of Funding: The government funded the blanket guarantee through borrowing and fees charged to covered financial institutions.

The August 7, 1997, announcement of the blanket guarantee stated that it was financed by "borrowing and bond issuance with government guarantee" (FIDF 1997). The FIDF also said that fees charged to covered financial institutions would play a part in the funding of the blanket guarantee (see Fees section).

To give additional credibility to the guarantee, the prime minister amended the Bank of Thailand Act in October 1997 using an emergency decree to allow the FIDF to draw funds directly from the government (Emergency Decree B.E. 2485 1997).

Though the blanket guarantee was included in the language of the letter of intent that Thailand submitted to the IMF, the resulting standby loan was not used to fund the blanket guarantee in any part (IMF 1997b).

The FIDF ultimately accumulated THB 1.4 trillion (USD 34 billion) in debt to cover its losses from bailing out guaranteed banks and finance companies. Of that total, THB 554.1 billion helped depositors protected by the blanket guarantee (BOT n.d.a).

8. Eligible Institutions: The full guarantee covered all banks and non-suspended finance companies.

The blanket guarantee announced on August 7, 1997, was extended to creditors and depositors in all operating financial institutions (FIDF 1997). This originally applied to all operating financial institutions following the suspensions on August 5, 1997. The only requirement was the payment of a fee based upon the value of covered assets (BOT 2018, ch. 5).

The August 14, 1997, letter of intent introduced a scheme to exchange claims on suspended banks with notes issued by state-owned banks KTB and KTT that the FIDF guaranteed[6] (Government of Thailand 1997, box 1).

9. Eligible Liabilities: The guarantee covered principal and interest on all deposits and non-subordinated liabilities, but there were caps on the amount of interest it covered.

The August 1997 announcement of the rescue package extended a guarantee covering all deposits and non-subordinated liabilities in all operating financial institutions following the second round of suspensions of August 5, 1997 (Government of Thailand 1997; Haksar and Giorgianni 2000). Depositors and creditors in all operating financial institutions were fully protected by the FIDF (FIDF 1997).

The FIDF was responsible for covering the full principal amount for accounts in all non-suspended institutions (Government of Thailand 1997, box 1). However, the responsibility for covering interest payments varied. For depositors in commercial banks, the FIDF covered interest up to a maximum rate of the average three-month fixed rate offered by the five largest commercial banks plus 300 basis points (FIDF 1997). In September 2007, the BOT imposed this cap on all commercial bank deposits (BOT 1999).

For depositors in all other types of financial institution, the FIDF covered interest up to a maximum rate of the five largest banks' average three-month fixed rate plus 600 basis points. For creditors in all types of financial institution, the FIDF covered interest as specified in the contracts up to a maximum rate not exceeding the average minimum lending rate of the five largest commercial banks, minus 400 basis points (FIDF 1997).

On October 25, 1997, the government's emergency decree on Financial Sector Restructuring defined depositors and creditors and specified that the blanket guarantee excluded subordinated debt, off-balance-sheet creditors, and shareholders' funds (Government of Thailand 1997, box 1). The emergency decree defined depositors to include "holders of negotiable certificate of deposit and promissory notes issued to borrow or receive money from the public" (Emergency Decree B.E. 2485 1997, 3). Creditors were defined to include creditors other than depositors, "whose creditor status arose from the financial institution . . . lending, purchasing of promissory note or holding of other debt instruments where the financial institution is the borrower, payer or issuer" (Emergency Decree B.E. 2485 1997, 3). The FIDF limited its coverage to depositors in 2003 (BOT n.d.b).

[6] For the 42 institutions that were suspended on August 5, 1997, both depositors and creditors had access to the note exchange scheme. For the 16 finance companies suspended on June 26, 1997, only depositors had access to the note exchange scheme (Government of Thailand 1997, box 1).

10. Fees: Member institutions were charged a percentage of the total value of their covered liabilities.

The BOT Act required covered institutions to make contributions to the FIDF while covered by a guarantee. This contribution amounted to a percentage of each financial institution's covered liabilities (BOT 2018, ch. 5). The FIDF collected the fees on a semi-annual basis. According to the letter of intent that the government signed with the IMF, the rate was 0.15% in December 1997 and 0.20% in June 1998 and December 1998 (Government of Thailand 1997, box 1). These fees were a part of the funding for the blanket guarantee (FIDF 1997).

11. Process for Exercising Guarantee: In the event of insolvency, the FIDF would honor the claims of creditors and depositors in baht within 30 days.

The FIDF stated that in the event of a firm's insolvency, depositors and creditors covered by the guarantee would be compensated within 30 days of the submission of claims, in baht (FIDF 1997; Government of Thailand 1997).

12. Other Restrictions: The BOT instituted a temporary deposit rate cap for member institutions, set limits on foreign borrowing, required companies to raise capital, and increased monitoring and oversight.

The Thai government, in its letter of intent, outlined several measures to prevent potential moral hazard among covered financial institutions. The first of these measures, in September 2007, was a temporary deposit rate cap of 300 basis points above the average deposit rate of the five largest commercial banks. In June, the BOT had temporarily set a ceiling of 12% on saving deposits, with separate guidelines for finance companies; it raised the cap to 14% in July. The FIDF also took steps to monitor and limit foreign borrowing and strengthened its monitoring of asset growth and general oversight (BOT 1999; Government of Thailand 1997).

All covered financial institutions were required to raise their capital. The government waived previous limits on foreign ownership to encourage banks to seek foreign participation (Government of Thailand 1997, box 1). Undercapitalized institutions that could not raise their capital were taken over by the FIDF (BOT 1999).

13. Duration: The government did not originally identify an end date for the guarantee.

The government did not originally identify an end date for the blanket guarantee. In 1997, authorities stated that they would replace the guarantee with a limited deposit insurance scheme following the stabilization and restructuring of the financial system. Authorities set a goal of incentivizing exit from the guarantee by 1999 through increased fees or making participation voluntary, although they did not follow through on those goals. The FIDF limited its coverage to depositors in 2003 (BOT n.d.b; Government of Thailand 1997). Deposit insurance was enacted on February 6, 2008, with the passage of the Deposit Protection Agency Act, at which time the blanket guarantee effectively ended. The new limited deposit insurance scheme covered deposits up to THB 1 million (Deposit Protection Agency Act 2008).

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