

EMERGING BOND MARKET IN THAILAND PROBLEM AND PROSPECTS

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INTRODUCTION

The Thai economic system has changed tremendously during the past 5-6 years because of its rapid growth. It is imperative for Thailand to adjust herself in order to withstand greater challenges that will be forthcoming as a result of deregulation of financial markets worldwide. With fast modernization of information and communication of technology, international money and capital markets have become integrated as financial systems worldwide, and they strive to achieve efficient use of resources.

Regional economic cooperation has also gained wider acceptance; the single European market came into effect since the end of 1992; multilateral trade negotiations within the framework of the General Agreement on Tariffs and Trade (GATT) and the Agreement on the North American Free Trade Area (NAFTA) were recently concluded while the Asia Pacific Economies Co-operation (APEC) continued to make progress. In the case of Thailand, the increasing demand of funds causes the traditional ways of fund mobilization insufficient and ineffective. Recognizing this fact, the Bank of Thailand (BOT) has initiated financial deregulation measures with a view to gearing the economy towards a more market - oriented approach, with reduced government intervention, while promoting efficient allocation of resources and savings, and maintaining Thailand's competitiveness in the world market.

A comprehensive financial reform plan was set in motion in 1990 for improving competitiveness, flexibility, and efficiency of the financial system. The first three-year financial reform plan for 1990-1992 focused on four significant areas (Choedchai and Vachira, 1993):

- Deregulation and liberalization
 - Interest rate liberalization
 - Relaxation of exchange control
 - Expansion of financial institution's scope of activities
 - Improving efficiency of portfolio management
- Improving supervision of the financial institutions
- Development of financial instruments and services
- Development of a payment system

In the second three-year plan (1993-1995), the authorities aim to further financial liberalization and deregulation through the following measures: savings mobilization plan, extension of financial services to rural areas, and development of Bangkok as a financial centre. The latest financial master plan has just been promulgated.

The most important measure affecting the development of the Thai capital market was the enactment of the Securities and Exchange Commissions (SEC) Act in 1992. Following the Act, SEC was established to supervise and develop the capital market. Before the promulgation of the SEC Act, debentures could only be issued by two types of companies-public and listed companies. Currently, under this Act, private limited companies are also allowed to do so.

In fact, the bond market consisting of the Government and state enterprise bonds has existed in the Thai financial system for a long time. Previously, the issuers were only the Government and state enterprises. However, the Government has not issued any bond since 1990 because of the budget surplus. The corporate debentures were issued since 1992, after the enactment of the SEC Act.

The objectives of this paper are to document the profile of the bond market in Thailand and discuss the problems constraining its rapid development. In addition, the actions necessary for developing the market in the future will also be discussed.

CURRENT STATUS OF THE BOND MARKET IN THAILAND

The bond market is considered to play a crucial role to stabilize the Thai financial system (Prasarn and Tipsuda, 1994). So far only the banking system and the stock market are the most significant constituents of the Thai financial market. They provide fund mobilization and savings opportunities for lenders and savers. However, a stable and sound financial system needs other savings and investment avenues besides stock market and banks. The functioning of the banking system depends on the behavior of interest rates. As Thai financial system is integrated with international system, the interest rate changes cause variability and risk of returns to investors and cost of funds to the fund users. The stock market helps to raise funds for private sector but the volatility of its return to investors is very high. The stock market is very sensitive to financial and other events. It can collapse due to a single unfavorable financial event. Under such circumstances, the bond market becomes a tool of stabilizing the financial system because it provides long term funds to businesses at less cost compared with the cost of bank funds and equity. It also provides savers steady returns without much swing in interest rates. Although the bond return is usually less than the stock market's return, it offers lower risk.

THE PRIMARY MARKET

The Government and state enterprises have played a major role in the bond market until the SEC Act was enacted in 1992. The Act allows private companies to issue debentures or other debt instruments to mobilize funds in addition to stock issues. During the fiscal

years 1986 to 1990, total amount of bonds issued by the Government in the primary market was 111,941 million Baht and total amount of state enterprises issues during the fiscal years 1986 to 1994 was 191,434 Baht. No government bonds were issued during 1991-1994 (Table 1).

Table 1: Government and State Enterprise Bonds Issued during 1986 - 1994

	(million Baht)									
	1986	1987	1988	1989	1990	1991	1992	1993	1994	Total
Government Bonds	2,000	9,000	26,660	12,981	11,300	-	-	-	-	111,941
State Enterprise Bonds	3,565	2,505	1,616	1,800	6,689	33,273	24,046	37,039	80,901	191,434

Source: *The Ministry of Finance*

Table 2: Amount of Securities Issued to the Primary Market

	(million Baht)								
	1992*			1993			1994		
	Issues	Value	%	Issues	Value	%	Issues	Value	%
Common Shares	3	1,248	19.64	41	34,028	35.32	73	82,020	42.17
Debenture									
- Domestic	2	5,107	80.36	18	21,145	21.95	33	59,804	30.75
- Foreign	-	-	-	18	40,295	41.82	21	50,246	25.83
Sub Total	2	5,107	80.36	36	61,440	63.77	54	110,050	56.58
Warrants	-	-	-	3	880	0.91	8	2,442	1.25
Total	5	6,355	100.00	80	96,340	100.00	135	194,512	100.00

Source: *The Securities and Exchange Commission (SEC)*

Note: * Since May 16 to Dec. 31

In 1994, the SEC permitted the private companies to make 135 issues of securities. The issue size of debentures was about 57% of newly issued securities' total value (Table 2). However, the real number of issues is not the same as illustrated in the Table 2 because the issuers have 6 months after the authorization date to undertake the offering of newly issued debentures. If they cannot complete the offering within 6 months, the SEC's authorization will be terminated.

There were 39 issues offered to the domestic market with total amount of 52,490 million Baht. Since 1993 there were 40 issues offered to the foreign market. Most of them were issued in Euro-market. Total value was approximately 84,722 million Baht. Due to the rise of the US discount rate many times last year, the Thai companies have stopped issuing Euro-Convertible Debentures (ECDs) in the Euro-market. In the Thai bond market, the major investors are institutional investors (61%). The low share of

individual investors in the bond market could be attributed to low per capita income, lack of understanding and low liquidity in the secondary market.

From the figures shown in Table 2 we can see that companies prefer to issue more debt instruments to mobilize fund than equity. Several reasons may be ascribed for this. For example, mobilizing funds by increasing registered capital is not always a good method especially for listed companies because it may have negative effects such as: decline in dividend per share, dilution effect, inconvenience to original shareholders to maintain their control, etc. Although borrowing from financial institutions may be a better alternative but it leads to higher interest charges for companies.

It may be observed that the primary bond market alone is not sufficient for a total development of the bond market. Most investors hold securities for short periods. They want to ensure that the securities they hold have enough liquidity. Therefore there is need for a market where they can buy or sell their securities easily. Thus if there is no such market, selling bonds into the primary market will become very difficult.

THE SECONDARY MARKET

The Government bonds have been the major debt instruments in the Thai capital market until recently. However, the trading of the Government bonds in secondary market has not been active. The main reason being that, in the early days, the BOT required commercial banks to hold the government bonds for branch opening. That mandatory requirement came about when the Government needed to issue a large number of bonds to fund the budget deficit. This policy resulted in a captive Government bond market. Although the BOT eliminated this requirement, the commercial banks remained inactive and they continue to hold the Government bonds as a part of legal liquidity reserves. Now the number of Government bonds outstanding is quite small because the Government has stopped issuing bonds since 1990 on account of its surplus position. Also the availability of bonds in the secondary market is low since the major group of holders are commercial banks who prefer to hold them for liquidity reserve. Table 3 shows the amount of government bonds classified by holders.

Another reason for an inactive secondary market for bonds in Thailand is that the Government bonds are used as collateral by borrowers of short-term loans from the BOT via repurchase market, called the Repo market. The Repo market was set up in 1979 to open up a channel for financial institutions to adjust their liquidity position and to provide an additional tool for the conduct of monetary policy. It is the exclusive secondary market for the Government debts available only to financial institutions, the Government Saving Bank, and state enterprises, Thus the holders of bonds use them for short-term borrowings from the BOT.

In addition to the Repo market, activities in the secondary market for bonds and corporate debentures also centre around the Stock Exchange of Thailand (SET) and the over-the-counter (OTC) market.

Table 3: The Outstanding Value of Government Bonds Classified by Holders

Holders	(million Baht)							
	1991	%	1992	%	1993	%	1994*	%
Bank of Thailand	33,723.8	22.37	33,157.1	24.76	21,746.6	21.600	21,649.6	24.00
Commercial Banks	85,809.2	56.91	73,917.6	55.21	55,803.0	55.430	48,369.9	53.63
Government Saving Bank	40.0	0.02	40.0	0.03	40.0	0.044	0.0	0.04
Financial Institutions	22,022.8	14.61	20,582.6	15.37	17,874.9	17.760	15,618.9	17.32
Other Domestic Sectors	9,184.0	6.09	6,196.3	4.63	5,206.4	5.170	4,520.5	5.01
Total	150,779.8	100.00	133,893.6	100.00	100,670.9	100.000	90,198.9	100.00

* estimated

THE STOCK EXCHANGE OF THAILAND (SET)

There are a few debt instruments listed on the SET (Table 4). The debt instruments trading in the SET is quite inactive. One reason is that there are too few debt securities in the SET. At the end of 1994, total market capitalization of all listed issues was about 3.3 trillion Baht while the market value of debentures including convertible debentures was approximately 4 billion Baht or just 0.12 % of total market capitalization (Table 5).

Another reason for the low bond activity in the SET is the inventors' preference to deal with large dealers. The underwriters place debentures mostly with institutional investors and big individual investors. These investors contact dealers disregarding the SET for buying or selling debentures. They save commission fee required when trading is done in the SET. Direct trading is possible because of few issues outstanding in the market. Yet another reason for the inactive bond market is the bonds held as reserves by banks and financial institutions and not for trading. Most bond investors are insurance companies and banks who invested in bonds in the past only for cash reserve purpose.

THE OVER-THE-COUNTER (OTC) MARKET

Most of the security trading transactions are conducted through direct negotiations between investors and traders. Although the SET acts as an organized secondary market, but the process of trading seems rather complex. Such trading practice causes inconvenience to both traders and investors, particularly individual investors, do not get fair prices as we can observe the remarkable gap between the bid and offer prices of each dealer in newspapers. Further, price quotation is neither centralized nor standardized because dealers or market makers operate separately; again we can observe different prices quoted by each dealer in the newspapers (see Table 6 as a sample). The nature of trading in the OTC market is on a point-to-point basis with no widely

connected network. This hampers the availability of the information on the trading volume.

Table 4: Debt Instruments Issued and Listed on the SET

	End of the Year				
	1990	1991	1992	1993	1994
Government Bonds					
Number of Issues	126	106	82	62	N/A
Amount Issued (mil.Baht)	221,790.80	196,085.63	175,560.62	138,802.27	N/A
Debt Outstanding (mil.Baht)	182,637.88	138,961.56	131,083.72	97,880.89	N/A
State Enterprise Bonds					
<i>Gov. Housing Bank</i>					
Number of Issue	1	1	1	-	-
Amount Quoted (mil. Baht)	887.19	887.19	887.19	-	-
<i>PTT Investment Bonds</i>					
Number of Issue	2	2	2	2	1
Amount Quoted (mil. Baht)	1,542	1,542	1,542	1,542	542
Corporate Debentures					
<i>Debentures</i>					
Number of Issues	N/A	N/A	N/A	N/A	11
Par Value (mil.Baht)	N/A	N/A	N/A	N/A	4,490
Market Value (mil.Baht)	N/A	N/A	N/A	N/A	3,645
<i>Convertible Debenture*</i>					
Number of Issues	N/A	N/A	N/A	N/A	3
Par Value (mil.Baht)	N/A	N/A	N/A	N/A	368
Market Value (mil.Baht)	N/A	N/A	N/A	N/A	344

Source: *The Stock Exchange of Thailand (SET)*

* Outstanding balance after converted to be ordinary shares

Table 5: Market Capitalization of Listed Issued on the SET As December 1994

	Issues	Value (million Baht)			
		Par	%	Market	%
Ordinary Shares	389	306,279	72.77	3,153,169	95.53
Preferred Shares	9	570	0.13	5,424	0.16
Unit Trusts	61	109,019	25.90	109,908	3.33
Convertible Debentures	3	368	0.09	344	0.01
Debentures	11	4,490	1.07	3,645	0.11
Warrants	21	148	0.03	28,266	0.86
Grand Total	494	420,874	100.00	30,756	100.00

Source: *The Stock Exchange of Thailand (SET)*

Table 6: Example of Price Quotation of Debentures by Each Dealer

Issues	Dealers			
	TFB	TISCO	KTT	Nithipat
BANPU				
Bid price (bht.)	745.99	-	758.88	745.74
Bid yield (%)	12.40	-	11.90	12.40
Offer price (bht.)	758.64	-	771.79	-
Offer yield (%)	1.90	-	11.40	-
FIN 1				
Bid price (bht.)	651.82	656.26	664.16	651.60
Bid yield (%)	12.40	12.30	12.00	12.40
Offer price (bht.)	668.06	680.89	680.77	676.16
Offer yield (%)	1.90	11.50	11.50	11.60

Source: Bangkok Post Newspaper as Feb. 1, 1995

Table 7: Trading Volume in the BDC (Nov.'94 - Feb. '95)

	November	December	January	February
Trading Value (mil. Baht)	994.098	863.740	3,092.268	3,220.588

Source: The Bond Dealers' Club (BDC)

THE BOND DEALERS' CLUB (BDC)

Due to the lack of secondary market for debt instruments, the SEC commissioned the Association of Securities Companies in March 1994 to study the development of secondary market for debt instruments trading. As a result, the Bond Dealers' Club (BDC) was established in September 1994.² The BDC has started trading in debt instruments since November 1, 1994. At present (January 1995) there are 86 members and so far 36 corporate bonds have traded in this market.

Trading system conducted in the BDC is quote-driven or dealer-to-dealer system, which is different from the system of the SET. The SET system is an order matching system where the settlement occurs only when bid price coincides with offer price. For the BDC's system, although the prices which a seller and a buyer quote are not the same, if the range of the prices is attractive they can negotiate with each other in order to complete the deal.

Individual investors cannot trade bonds directly in the BDC because the system is dealer-to-dealer system and the communication is done only via terminal screen of each dealer. Further, the minimum volume per transaction is 1 million Baht which is wholesale trading while a very few individual investors can often make such volume. Whenever they want to buy or sell bonds, they must contact dealers, who will quote daily prices. Since the BDC activities took off from November 1, 1994 the trading

volume has increased dramatically. Table 7 shows the trading volume in the BDC since the end of November 1994 through February 1995.

MARKET MAKER IN THE THAI BOND MARKET

A dealer has the important role as market maker in both the primary and secondary bond markets. In the primary market, dealers act as intermediary and distribute bonds from issuers to investors. They will buy a new issue from an issuer and resell it to the public. Sometimes, if the issue size is large, many dealers may join to form a syndicate to underwrite the issue. Thus, dealers ensure that there is a primary market for issuers. In the secondary market, their most important role is to function as a market maker. As market makers they create liquidity of securities by being always ready to quote the bid and offer prices and being ready to sell or buy securities.

There are two market maker systems. There is a system based on non-competing market makers (specialists) making two-way markets in a relatively small number of designated securities, with each market maker dealing in different securities. The another system is based on competing multiple market makers with several market makers making markets in the same securities. A further distinction may be made between firm buying and selling quotes, i.e. quotes at which a market maker stands ready, or is even obliged by regulation or self-regulation, to deal in specified amounts; and indicative quotes serving as a starting point for price negotiation.

In the case of Thailand, the market maker system is based on competing multiple market makers system. Actually there is non-competing market maker system in Thailand but in the form of syndicate market maker. However, to be a market maker, the dealer need to have enough money to buy and sell debentures all the time; thus only one dealer may not sustain this task alone. Moreover, most of the dealers in Thailand are not big enough except the big commercial banks such as the Bangkok Bank and the Thai Farmers Bank. So the members will join together in making a bid and offer price. Nonetheless, some dealers outside the group may compete with the group by making different bid and/or offer price if the issues are very interesting.

PROBLEMS IN THE THAI BOND MARKET

Although the Thai bond market has grown dramatically since 1992, there are some constraints which still keep the market from moving ahead. Such constraints depend upon regulatory environment, readiness of participants, availability of qualified personnel in this field of interest rate structure. Some must be alleviated domestically while some depend on outside factors and are uncontrollable.

STRUCTURAL PROBLEMS IN THE PRIMARY MARKET

Although there are many companies which have issued debentures, a lot of them still are not very keen to issue debentures in the domestic market. One reason is that, a company

wishing to offer its debentures, especially to the public, must go through mandatory procedure which is inconvenient to them compared with borrowing from commercial banks. For example, "the companies are required to be audited by the auditors approved by the SEC and the SET. It must be rated by a Credit Rating Agency (CRA). During the life of the debentures, the issuing company must disclose detail of its operation. These act as constraints particularly when financial incentive of issuing debentures is low" (Banthoon, 1994). What is low financial incentive? Looking at domestic interest rate structure, companies that are financially strong enough to issue debentures can usually borrow from local bank at Marginal Lending Rate (MLR) which is currently about 13%, or borrow from the international market which has lower interest rate. Suppose that cost associated with issuing debenture is 2% (underwriting fee is about 1-2%), a company will see the benefit of issuing debenture only if the coupon rate is below 10.75%. But if the coupon rate is too low, investors may not buy the debentures otherwise the debentures must be sold with a high discount rate meaning that the issuer will get low proceeds at the issue date but repay at the face value at maturity date. The company thus is reluctant to issue straight debentures. To attract investors and achieve low coupon rate, companies are turning to equity-linked debentures which a limited to few companies which can tolerate share and/or earning dilution. Although there are many companies willing to issues debentures but increase of issues in the market along will not be enough. The important thing is the quality of the issuers.

Generally, in the countries where the bond markets are well developed, the inflation rate is low, the amount of savings is high while interest rate is rather low so that no one wants to deposit their money with commercial banks. Further, any company which would like to mobilize funds by issuing debentures should be large, financially strong and creditworthy. In Thailand, per capita income of people is too low thus affecting the level of savings (Table 8). The domestic interest rate quoted by commercial banks and finance company seem to be high. So, if the coupon of debenture is lower than the bank interest rate, no one will buy debenture unless the issuer offers other benefits which make the issue attractive enough to investors.

Table 8: The Percentage of Savings per GDP of Thailand Since 1988 - 1992

	1988	1989	1990	1991	1992
Private Sector	22.9	23.7	22.4	22.8	24.8
Government Sector	7.1	7.9	10.2	10.9	9.5
Total	30.0	31.6	32.6	33.7	34.3

Source: Office of the National Economic and Social Development Board

Furthermore, most of companies prefer to issue unsecured bonds which must be rated by a Credit Rating Agency (CRA). But there is only one CRA, i.e. Thai Rating and Information Service (TRIS), approved by the SEC. Although Standard and Poor's (S&P) has given technical assistance to TRIS but there is need for more than one CRA to compete with TRIS. It will help to reduce time for the issuing companies which have to

wait for a long period for TRIS's service. Many developed markets in other countries have more than one CRA which is responsible for high standard of credit rating.

STRUCTURAL PROBLEMS IN THE SECONDARY MARKET

The organized secondary market for bonds is the SET. Because of the low liquidity and the complicated trading system, the SET is not suitable for bond trading. These factors are responsible for the emergence of the BDC - a new organized secondary market for debt instruments. It cannot be said whether the BDC is a right measure for developing the bond market. It has just operated for five months but, at least, the statistics shown in Table 7 indicate the promise of a good trend. The only problem is that there should be more issues traded in the market. Compared with about 500 issues traded in the SET, there are only about 36 issues traded in the BDC.

As explained earlier, another secondary market is the repurchase market which is operated by the BOT. In the past, only securities guaranteed by the Ministry of Finance could be used as collateral for short-term borrowing. Such securities were held mostly by financial institutions and at present, the number of such securities is very limited. To increase the liquidity of the bond market, the Ministry of Finance has just amended the related laws, accepting that securities non-guaranteed by the Ministry of Finance can be traded in this market. Examples of these securities are the BOT bonds, state enterprise bonds, and bonds of financial institutions established by specific laws such as the Export-Import Bank of Thailand and the Industrial Finance Cooperation of Thailand (IFCT).

However, these securities exclude corporate debentures. In fact, some companies such as Thai Farmers Bank and Bangkok Bank; which issued debentures have enough solid financial status so that their debentures should be traded in this market they have received company-rating AAA from TRIS. If the BOT allows corporate debentures with good credit ratings being traded in the repo market, it will enhance the liquidity of these debentures in addition to trading in the BDC or else.

ABSENCE OF BENCHMARK RATES

The most significant factor hindering the development of the bond market is the lack of benchmark rates. The reason for the lack of benchmark rates is that Government bonds do not have liquidity due to limited number of bonds available and the holders do not like to trade the Government bonds in the secondary market. In addition, the current budget surplus since 1990 allows the Government to spend money without having to issue bonds to raise funds. Therefore, when there is no true benchmark, investors have no reference of risk free return they should compare before they decide to invest in the bond market. For the time being, dealers are using deposit rates and lending rates as their benchmark. Some traders also compare yield on bonds with the P/N rates to ensure investors that they are better off by investing in bonds (Research Institute - Securities One Public Co., Ltd., 1994). The benchmarks they are using are not standardized

because the deposit rates, lending rates, or P/N rates of each financial institution are different (Table 9).

Table 9: Interest Rates of Large Commercial Banks

Banks	Savings (%)	Fixed Deposit (%)	MRR (%)	MLR (%)
Bangkok Bank	6	9.75 - 11.00	12.50	12.75
Krung Thai	6	10.25 - 11.00	12.75	13.00
Thai Farmers	5.5	10.25 - 11.00	12.75	12.75
Siam Commercial	5	9.25 - 10.75	13.00	12.75
Bank of Ayuthaya	5	10.00 - 11.25	13.25	13.0

Note: Fixed deposit rate for 3,6 or 12 month maturity depend on the amount of deposits

Source: Puchatgan Newspaper, March 15, 1995

The way to create the benchmark rates is that there should be risk free securities having different time to maturity and are issued consistently. It will help to draw a yield curve of risk free rates for securities with different time to maturity so that everyone can use the same benchmark rate as reference plus required premium for their required yield from their investment in the bond market. The best securities for creating benchmark rate are the Government securities. However, within next 2-3 years there would not be any Government bond issued in the market. But the authority could support the bond market via the state enterprise bonds in order to create the benchmark rate, because the number of the state enterprise bonds are sufficiently large and state enterprises have capital investment budget of about 320,000 million Baht per year. However, the issuance of state enterprise bonds is disordered and inconsistent. The number of issues in each period is not symmetric, some have equal maturity but offer different coupon rates, etc. In addition, different issuers have distinct quality; thus credit rating for the state enterprises bonds may be essential for comparing coupon rates of each state enterprise bond. If we want to use state enterprise bonds to create benchmark rate, it is necessary to have cooperation among the state enterprises in launching their bonds into the market, or the Ministry of Finance can play a role of middleman to take care of this .

TAX ISSUES

The ambiguous tax provision on capital gains for corporate and individual investors gives a dubious picture to investors to measure their after tax net return and thus affects their decision to invest in bonds. There are many aspects which need to be ironed out which we cannot discuss entirely in this paper. However, we will take some examples of the tax ambiguity. Let us take the case of a bond purchased a short time before a coupon date. The buyer already pays for the accrued interest included in the price but when he receives the coupon, the full amount, rather than what he earns after his purchase, becomes the taxable base. Another example is when a bond is purchased at a premium.

According to the code, the coupon, rather than the yield, determines the taxable base. In each of these two cases, the buyer pays taxes on a higher base than he actually earns.

Further, there is a tax problem which burdens investors when they transfer bonds or debentures at the discounted prices. According to the section 40 (4) of the Revenue Code, the variance of the issue price lower than redemption value or par value of debt instruments must be taxed at 15%. Many issues of corporate debentures are sold at the discount price of this section of the Code becomes a tax-burden of an individual who buys debentures at the price lower than redemption value from the subsequent trading. Probably, this is a very important obstruction of liquidity problem in the secondary market. Recently, the revenue Department has proposed a solution to tackle this complicated tax issue. The proposed tax collection plan will be a 15% withholding tax on the discounted portion for the initial trade, when the bond is transferred from this issuer to the individual investors. This will be a one time charge only; the subsequent trading will not be subject to further taxation (Research Institute - Securities One Public Company Ltd., 1994). For the duplication of tax base when the buyer pays for the accrued interest as cited above, the revenue Department has proposed to use the net interest received for the tax base but only for institutions having license for securities trading (Matichon Newspaper, December 17, 1994). However, these propositions have not been officially promulgated so far. Table 10 displays the summary of tax implications related to debt instruments.

Table 10: Tax Implication for Debt Instruments

	Discount	Interest	Capital Gain
For Individual			
<i>Thai</i>			
• Debenture	15 % W/T	15 % W/T	Exempt
• Notes	15 % W/T	15 % W/T	15 % W/T[1]
<i>Foreigner</i>			
• Debenture	15 % W/T	15 % W/T	Exempt
• Notes	15 % W/T	15 % W/T	Exempt
For Institutions			
<i>Thai</i>			
• Debenture	No W/T	No W/T	No W/T
• Notes	-	1% W/T	-
<i>Foreigner</i>			
• Debenture	15 % W/T	15 % W/T[2]	15 % W/T[3]
• Notes	15 % W/T	15 % W/T[2]	15 % W/T[3]

Source: Finance Once

Notes: [1] Only if the transferor is the holder

[2] 10% withholding tax for Double Tax Treaty (DTA) Countries

[3] Recipient who is the resident of DTA country is exempted from Thai tax

SECURITIZATION SCHEME

According to the SEC regulation, there are only two kinds of debentures, viz. secured and unsecured. Convertible debentures or warrants attached to debentures are just sweeteners to attract the investors. However, the capability of a company to issue debentures is limited by its ability of repayment of debts, risk of default, restrictive covenant in bond agreement, etc. This makes the limited number of issues in the market. Securitization of assets is a way not only to help financial institutions enhancing their funds mobilization alternative but also to increase the number of efficient products in the bond market. In 1992, the value of securitized assets in the United States was about 215% of GNP (The Capital Market Research Institute, IFCT, 1992), showing that it was very popular. Moreover, it is successful in some European countries such as England, France, Sweden, and Italy. One advantage of this instrument is that there are steady proceeds to repay the holders, depending on the quality of assets which are securitized. Due to the limited number of debentures and less varieties of products in the Thai bond market, securitization may be a choice to solve this problem. Now, regulation on the securitization of assets, particularly on mortgage-backed securities, is being drafted for use in the near future.

CONCLUSIONS

In the past, the bond market in Thailand was dominated by the Government and was not well developed. At that time, the Government used it as an important source of fund mobilization to compensate for its deficit fiscal balance. The major holders of the Government bonds are financial institutions, and they have been required to maintain the Government bonds and the Government guaranteed state enterprise bonds against their deposits. So the trading activities in the secondary market has been seldom active. The corporate bond market has become an important source of funds in the recent years, because the banking system and the stock market cannot serve the business for the large demand of funds due to the rapid economic growth. The limitation of the banking system is the uncertainty of interest rates while the limitation of the stock market is the issuing companies have to maintain the profitability, giving steady return to the shareholders and must tolerate the dilution effect when they increase registered capital.

The Thai bond market has taken off since 1992 after the enactment of the SEC Act. The key measures for developing the bond market are: creating infrastructure in the primary and secondary markets and improving the regulatory environment to support the liquidity of the market and to protect the benefits of concerned agencies. Fortunately, the authorities - the Ministry of Finance, the BOT, and the SEC - perceive the necessity of the bond market as an important financial infrastructure to stabilize the Thai financial system; thus many efforts were pushed to develop the market. As a result, within two years, the number of bond issuers and the market capitalization have increased dramatically, both in the private sector and the state enterprise sector. Also, TRIS - only CRA in Thailand - was incorporated as an important appraiser of credit risk for investors. Besides, after doing feasibility study in March 1994, the BDC could start to operate as the organized secondary market for bond trading among dealers since

November 1994. Furthermore, some tax issues still being impediments, they are under the consideration of the Revenue Department to be alleviated in the near future. Expanding the investor base especially for institutional investors is another significant measure to augment the sources of funds in the primary market; many mutual funds were set up to promote saving mobilization, some of them have policy to invest only in debt instruments.

It is difficult to say how large the market will be in the future. Increase of issues in the market alone will not be enough but those issues must be well qualified. If we consider only the private sector, there are not many companies which can issue debentures because only large companies with enough credibility can do that. Issuing debentures is like borrowing money directly from ultimate savers, so if the issuers cannot make ultimate savers confident of them it seems to be difficult to raise funds by doing so. Besides, as far as the Government will not issue bonds, it is very difficult to have the true benchmark of interest rates. Although the Government intends to use the state enterprise bonds in order to create the benchmark rate in the market, it may not be possible to do so if the issuance of the state enterprise bonds is not centralized or standardized. Lastly, in countries where the bond markets are well developed, the promotion of public savings is high together with low inflation, and the domestic interest rate is low so that it is not attractive for people to deposit their money with the banks. In the case of Thailand, the domestic interest rates for deposits are somewhat high, thus the people who are risk averse will prefer putting money into financial institutions than investing in bonds, unless they offer higher coupon rate and have high liquidity too. Nonetheless, all of the concerned agencies are putting many efforts to support the bond market as another source of funds in the Thai market.

Notes

1. See Bonthoon Lamsam (1994). "The Local Bank's in Enhancing the Primary Market and the Development of the Secondary Market," *The 1994; Thai Bonds Conference*, April 18-19, Bangkok; Srichi, S. and Weerayuth, R. (1994). "The Thai Bond Market: An Update," *The 1994: Thai Capital Markets Conference*, August 17-18, Bangkok; Teerachi, P. (1994), *Debt Instruments Market: Evolution, Trend and Impact*, The Bank of Thailand; Prasarn, T. (1994), *Debt Instruments Market: Evolution, Trend and Impact*, Thammasat University.
2. See The Association of Securities Companies, (1995) *Bond Dealers' Club*.

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