

Troubled by its past, regularly hit by doubts over its future and facing a host of political, legal and regulatory obstacles, the once respected Bank of Thailand has fallen on hard times. Can its embattled governor Chatumongol Sonakul pick up the pieces? By Ben Davies.

# The battle to reform the Bank of Thailand

Large marble pillars dominate the entrance to the Bank of Thailand (BoT) in the sprawling northwestern district of Bangkok. Inside the seven-storey building, beyond the bronze garuda (a gift from Bank Indonesia) and the handful of security guards, the air of academia is almost palpable. Central bankers tiptoe past a giant golden plaque commemorating the 50th anniversary of the royal wedding. Even visiting journalists speak in respectful whispers.

On the morning of May 7, 1998, Chatumongol Sonakul, newly appointed governor of the BoT, entered this venerable institution that for more than half a century had acted as the guardian of the nation's financial stability. For the 54-year-old Chatumongol, a former permanent secretary at the Ministry of Finance and a life-long bureaucrat, it must have been a triumphant moment. Not only had he risen from the ranks of a humble economist at the fiscal policy office to the vaunted position of BoT chief, but alongside finance minister Tarrin Nimmanahaeminda, he had also become one of the two most powerful regulators in the country.

Yet the institution over which he now presided had been almost irrevocably sullied. Within days of the devaluation of the baht on July 2, 1997, the BoT had gone from being the darling of all central banks to a pariah, lambasted by politicians and bureaucrats alike and largely blamed for the financial crisis that had befallen the country.

The BoT's sins are widely known. Between December 1996 and July 1997, it gambled an estimated \$24 billion on a futile bid to defend the baht. The crisis deepened when a department of the central bank, the Financial Institutions Development Fund (FIDF), incurred losses of Bt1.1 trillion (\$29 billion) while trying to support the fraud-ridden financial sector. Those errors of judgement cost the last three BoT governors their jobs. A dozen past and former officials are under criminal investigation over alleged breach of duty. Others have simply packed up and left the bank.

"The Bank of Thailand's reputation has been shattered," says the head of one financial institution. "It will take a long time to rebuild it."

The appointment of Chatumongol just days after the departure of its former governor Chaiyawat Wibulswadi in many ways heralded a total break from the past. A blunt-spoken aristocrat renowned for his single-mindedness, Chatumongol's task was not simply to restore confidence but to transform the very culture of the once mighty BoT.

"I am a hatchet man by nature, not an administrator," says Chatumongol from the spacious anteroom on the fourth floor of the BoT. "I lead from the front. And I expect others to follow."

The Bank of Thailand was founded on December 10, 1942, with the mandate of supervising financial institutions, formulating monetary policy and managing the country's assets



and liabilities. It rapidly grew in scope and stature until it could lay claim to being one of the most pre-eminent institutions in Asia, by steering the country through a series of financial and political crises that might have destroyed a lesser institution. During the late 1980s and early 1990s, the BoT was consistently voted as one of the best central banks in Asia. It recruited the cream of the nation's scholars, who were sent to elite business schools around the world.

Yet in hindsight, its reputation masked a number of fundamental weaknesses. "The central bank's reputation for smartness and integrity was very much a managed image," says one financial analyst. "They used to speak in a highly competent manner, but in many cases, they were utterly incompetent. There was a civil service mentality."

Writing reports on weighty matters that were rarely published may have boosted self-esteem, but it did little to cultivate independent thought and action. Few if any of the BoT staff had any real practical experience of commercial banking. The fact that large numbers of staff had worked together for 30 years lent the atmosphere more of a gentleman's club than of a serious central bank. "It was so bureaucratic that I couldn't handle it," admits a BoT official who left in the mid 1980s.

Lack of structure only exacerbated the problems. Beneath an appearance of order, the archaic system of management and the lack of any real accountability meant that many of the checks and balances were never put in place. "In the BoT there was a mindset," recalls one senior banking official. "You had a lot of very talented people. But they also had an ego. Because these people had clout, everybody had to pander to them." The other side of the coin, however, was that they could also be pandered to. Despite having a supervising department to monitor the books of financial institutions, the central bank took no action despite an explosion of lending in the early 1990s. When the collapse finally occurred with unexpected rapidity, it transpired that some of the banks under the BoT's supervision had non-performing loans as high as 75% of their loan book.

Meanwhile, at the top of the bank, the consensus style of management and the rigid hierarchy stifled initiative. Former BoT officials recall how dissent at the highest levels of the BoT was looked upon as betrayal and how in recent times some of the brightest central bank officials were sidelined for being too outspoken. It took a major crisis to reveal the flaws. When the BoT took out more than \$24.3 billion in forward contracts and currency swaps to defend the baht, it exposed a total lack of understanding of currency derivatives. Within hours of the announcement that Thailand would effectively devalue the baht, the currency moved sharply down. In the following days, as the baht continued its downward spiral, the BoT proved powerless to act. Eventually the position was unwound, but by then the government had been forced to accept a \$17.2 bailout from the International Monetary Fund.

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In an independent inquiry held in the aftermath of the crisis, considerable blame was placed on errors of judgement and consensus management. "Indecisive action resulted in increasing bad debts, which became a chronic problem," said the report drawn up by the Nukul Commission. "Additional management errors caused extensive damage."

Chatumongol was appointed in May 1998, with a clear mandate to rebuild the central bank and turn it into a professionally run organization. The choice was in many ways significant. Chatumongol was a civil servant by training, not a banker. But he had a track record of getting things done and a reputation for being incorruptible.

"I think it was an extremely inspired move by Tarrin to appoint Chatumongol," says one banker. "They knew that they could not control him, but that he was the best man for the job." Tarrin's rationale for appointing Chatumongol may also have been influenced by other factors. It is no secret, for example, that the IMF was placing severe pressure on the government to clean up the bank.

Within two months of taking the job, Chatumongol showed his mettle with a series of major policy initiatives. Despite strong opposition from the IMF, which advocated high interest rates as a means of supporting the currency, he engineered a fall in interest rates in a bid to breathe new life back into the suffocating economy. That bold initiative was followed by the drafting of a new BoT Act to make the central bank more independent and concerted moves to force banks and finance companies to up their provisions.

Chatumongol has also worked hard on restructuring the organization by bringing in the technical expertise and putting in the structures that it had hitherto lacked. Responsibilities at the BoT are now divided into seven areas, each headed by an assistant governor who reports to the governor himself. This means that just four layers of management separate the governor from operations, compared with seven layers under



Tarrin (right) and Chatumongol rarely see eye to eye.

the previous system. To bring in new expertise from outside the bank, Chatumongol also appointed key outsiders like Chaktip Nitiphon, former country manager of Credit Agricole Indosuez and Kiatchai Sophastienphong, a former senior vice president of the Siam City Bank. He also beefed up the legal department, spearheading a flurry of criminal investigations against officials deemed responsible for serious violations.

Even more far-reaching has been the overhaul of the supervision department, which is now headed by deputy governor Tarisa Watanagas. Prior to the re-organization, supervisors were officially restricted to examining the same bank's book on a maximum of two occasions. Under the new structure, the same team of supervisors will continuously oversee one particular financial institution – be it a bank or finance company – with their reports checked in turn by the heads of other supervision teams.

"The problem with the central bank [when I came in] was that they knew nothing about central banking," says Chatumongol. "They knew economics extremely well. They knew about supervision rules the old way. But they were not doing risk management or other new techniques because they lacked the training and organization."

At a broader level, Chatumongol, advised by a working committee headed by Gerald Corrigan, a former member of the Federal Reserve, has also established a new Monetary Policy Committee to advise on the setting of interest rates and other key inflation rate targets. Of the nine directors appointed to the new committee, six will be appointed from outside the central bank.

Perhaps the biggest challenge facing Chatumongol, however, has been to implement a wholesale transformation of the bank's existing culture. If before, the BoT's hierarchy was primarily based on seniority and often personal relationships, the emphasis now is on a meritocracy. Executives will in future be paid on performance. Promotions will be carried out on a similar basis. In a country where the value of relationships cannot be overstated such radical behaviour almost amounted to heresy. Several central bankers left or accepted early retirement. But their places were filled by a younger generation of BoT scholars prepared to accept change. "A lot of people like a comfortable life," says Chatumongol. "They don't want to run. But there are always people who want to take up the challenge and our staff here still have more PhDs than probably any other central bank – even the US Fed."

Chatumongol's no-nonsense approach has won high marks from outsiders. "Chatumongol has done a very solid job in giving back respectability to the Bank of Thailand as a professional, independent body," says Korn Chatikavanij, president of JF Thanakom. "He is probably the most competent governor that we have had since Khun Chavalit." Even his critics (and there are many of them) admit that while Chatumongol's management style is unorthodox, his uncom-

promising personality and his readiness to seek outside assistance have had a beneficial effect on the bank both in terms of increased transparency and the implementation of internal risk controls.

That sentiment is supported by the latest economic indicators. Since Chatumongol took over the reins of the BoT, the economy has stabilized. From a low of Bt43 to the US dollar in May 1998, the baht has strengthened to around Bt38. Short-term interest rates have also tumbled from 15% to less than 5% – their lowest level in more than a decade.

Chatumongol's apparent success in restoring confidence in the economy has, however, masked less favourable traits. Even

from the very earliest days, his uneasy relationship with Tarrin has been no secret. A row over a key bank appointment in mid-1998 brought simmering tensions to the boil. When the top job at state-owned Krung Thai Bank fell vacant, Chatumongol pushed for Mechai Viravaidya, the outspoken social activist and former chairman of the Telephone Organization of Thailand (ToT), to take up the post. A long-time associate of Chatumongol's with a clean track record, Mechai was widely known for his success in promoting family planning and

other social development programmes. But the former economist had no experience of managing a bank. Tarrin initially resisted the move, preferring to recruit a seasoned banker. Chatumongol, however, eventually got his way.

In the event, Tarrin's judgement proved correct. Mechai resigned after a leaked report by PricewaterhouseCoopers put NPLs at the bank at 84%. Mechai's departure was followed by nine of the bank's 10 directors. The unfortunate episode undoubtedly strained relations between Tarrin and Chatumongol. It also provided clear parallels with the BoT. Krung Thai's problems were not restricted to operational systems but to the very culture of the bank.

Tarrin, widely considered one of the country's most erudite finance ministers in decades, has not been the only one to

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Under pressure: Tarrin Nimmanahaeminda.

## Courting controversy

Perhaps the most surprising thing about Chatumongol Sonakul, holder of the highest office at the once mighty Bank of Thailand, is that he was chosen as governor at all. A former permanent secretary of finance and a widely admired bureaucrat in his own right, he has long been renowned for his outspokenness, his controversial style and his numerous clashes with politicians. It was Chatumongol who was behind efforts to overhaul the nepotistic and inefficient Ministry of Finance (the MoF) and Chatumongol who as director general of the excise department at the MoF went after tax evaders – a crusade that almost cost him his job.

Even before the start of the Asian crisis, Chatumongol stated publicly that the central bank should abandon its fixed link to the US currency in direct contravention to the government's and the BoT's stated policy at the time. "He is a ruthless

fighter and a man of enormous vision and drive, but he never was a banker," says one analyst.

Born into minor royalty on September 28, 1942, just three months before the BoT was founded, Chatumongol was educated in Britain's upper-crust Harrow Public School. He went on to study at Cambridge University where he earned an honours degree in mechanical sciences and economics. After attending Harvard University, Chatumongol followed the course of many wealthy Thai families, joining the civil service as a junior economist at the Ministry of Finance before working his way up the ranks to the very highest post.

Chatumongol's outward appearance is in many ways misleading. Impeccably dressed, with a very English accent and a discernible streak of arrogance, he encapsulates the image of Thai gentry who have studied abroad. But if Chatumongol

is a product of Thailand's establishment, he has few qualms about rustling its feathers.

In the course of his career, Chatumongol has taken on everyone from finance ministers to prime ministers. In the name of good governance, he has even unleashed a volley of criminal charges against many of the individuals he mixes with at a social level. "We are suing so many people that I can't play golf any more," he confesses. "Because they play regularly on the same courses, I get embarrassed and it's not nice."

Such sensitivities do not always extend beyond the putting greens. Colleagues describe him as pugnacious and unpredictable and on some occasions even positively frightening. Yet perhaps the most remarkable characteristic that the governor possesses is an absolute faith in his own judgement.

"I don't jump off cliffs without looking to see what is below," says Chatumongol. "But if wolves were behind me and I came to a ravine, I would jump and hope that a gust of wind took me to the other side."

feel the governor's displeasure. Local bankers complain that Chatumongol is unpredictable and that he employs bully tactics to make his point. "He is rude and subtle and that is not what you expect of the governor of the central bank," complained one local banker after the governor had ordered Thai banks to lower costs of the salary payments system. Says another: "He has tried to do the right things, but the wrong way."

Chatumongol himself refutes allegations that he is unsympathetic. "People say I don't listen, but that's not true. I have strong views and I fight like mad, but I always hear what people say."

The latest and in many ways the most damaging fight broke out in March after the Ministry of Finance re-submitted a draft amendment of the BoT Act to the Cabinet. The most contentious revisions centred on the conditions under which a governor could be fired, along with the right of the MoF to transfer surplus funds from the BoT to the MoF in cases of emergency. In an unprecedented display of anger, Chatumongol reportedly threatened to resign unless the offending clauses were deleted. Although the BoT subsequently retracted the statement, it has continued to fight what it deems to be interference in its internal affairs.

Ironically, the new amendments, if adopted, will go a long way towards ensuring that the BoT gets a freer hand in managing its own affairs. Under the new act, the governor will be awarded a five-year term with a maximum of two terms. The amendments will also make it more difficult for the MoF to fire the

governor – a fate that has befallen all three of Chatumongol's predecessors.

But the most contentious clause has yet to be resolved. The MoF is advocating that the BoT should consolidate its foreign exchange reserve accounts into one account – a standard practice for many central banks. Any resulting profits from foreign exchange gains could then be used to pay off the debts incurred by the FIDF in its failed attempt to save the 56 troubled finance companies. The BoT, however, stridently opposes the plan, arguing that it needs to set aside 200% reserves against bank notes in circulation to provide a cushion against any future appreciation of the baht. "Using the reserves to solve the problems of the FIDF would be short-sighted as it could lead to another crisis of confidence, requiring more funds to resolve," wrote Dr Kriengsak Charoenwongsak, executive director of the Institute of Future Studies for Development in Bangkok in a recent paper.

The battle has divided bankers, many of whom believe that both the MoF and the BoT should bear equal responsibility for their respective roles in failing to stem the financial crisis. But their sentiment masks one fundamental truth. It was the BoT's misguided defence of the baht that led to the snowballing of the crisis.

"Do you define independence by law or by practice?" questions Sataporn Jinachitra, senior executive vice president at Siam Commercial Bank. "Compared with any other central bank in Asia, the Bank of Thailand is independent. The law



**Chatumongol Sonakul:** "The biggest challenge facing the BoT is the execution of what we are now doing."

did not fail. It was the persons who failed." The war of words has now reached epic proportions with both sides using the media to push their causes. Observers claim that Tarrin and Chatumongol's differences are irreconcilable, that the central bank's cherished independence is under threat and that the economy will suffer. "Unless these differences are resolved quickly and amicably, confidence in Thailand's monetary and fiscal discipline will be gradually undermined," says a recent report by Merrill Lynch.

Yet, far from being a conflict over the central bank's independence, the battle is much more over its accountability with both parties trying to strengthen their hand. Tarrin has already stated that he wants a more independent central bank. The issue now is to make sure that the relevant checks and balances are put in place. "It has been a battle between two very smart, very arrogant bankers," says the head of one financial institution. "Tarrin thinks Chatumongol gets too much of the credit and Chatumongol thinks that Tarrin gets too much of the credit. Yet fundamentally they are not that far apart."

In the latest show of brinkmanship, Chatumongol has raised the stakes even further. On April 11, the BoT confirmed that it was bringing criminal charges against Sirin Nimmanahaeminda, the finance minister's younger brother, on allegations that he violated banking regulations during his seven-year tenure as president of Krung Thai Bank. This is likely to ensure that any attempts to unseat the governor will be construed by the opposition as political meddling.

"This is Chatumongol's way of showing who is boss," says Francis Middlehurst, former head of research at Crosby Securities. "And with elections coming up, he is in a formidable position. But Tarrin is an extremely smart operator and to my mind they will almost certainly work out a compromise."

Others claim that if it weren't for Tarrin, the temperamental governor would have been fired a long time ago. "The funny

thing is that he would probably like to be fired," says one banker. "Then he could blame it on the politicians."

Yet the embattled governor is unlikely to step down of his own volition. "I don't like to go anywhere and not complete the job," he says with considered understatement. "I just want to pay my debt to society after working 30 years at the ministry. I would like to make the country a better place for me and for other people."

Indeed, Chatumongol looks to be digging in for the long run. With the top management structure firmly in place, the focus is now on reorganizing the 25 sub-divisions of the BoT to put them on a par with any other modern central bank. That could take another two years to reap dividends. To complete the dramatic rebuilding of the central bank so that all the operational and risk management systems work to their maximum ability could take considerably longer.

"The biggest challenge facing the BoT is the execution of what we are now doing," he says. "There are a lot of people who don't like working this way. That's because the rest of the country is still relationship-based."

Chatumongol's crusade for good governance and transparency at the BoT marks a defining moment not only for the bank but for the very country as a whole. After years of cronyism and money politics, a growing chorus of voices is now demanding change. One of the biggest bombshells came in March when the newly formed electoral commission disqualified 78 out of 200 newly elected senators on charges of electoral fraud, heralding the beginnings of a cleaner and more open political culture.

Even more momentous was the decision several weeks later by the interior minister Sanan Kachornprasart to resign following allegations that he had concealed his assets by fabricating a Bt45 million loan from a private company.

"It's a brave new world," says Andrew Stotz, bank analyst at SG Asia Credit Securities. "It's the best thing that has ever happened since I have been in Thailand."

Nor is it only on the political level that things are changing. Moves by the Securities and Exchange Commission to force companies to seek a credit rating for all bond issues have provided additional evidence of a crusade for increased transparency — one of the great legacies of

Chatumongol. Yet the real test of his achievements will not be known for several years until his structural reforms bear fruit. So far he has successfully implemented policy objectives and unleashed a complete overhaul of the bank's archaic operating and management systems. But the litmus test will be the extent to which the BoT will be able to command international respect and credibility if and when the governor finally steps down.

"Chatumongol has become a larger than life figure almost akin to Greenspan at the US Federal Reserve," says Rob Collins, chief executive of Univentures Public Company. "People no longer think of the Bank of Thailand, they think of Chatumongol. And that could leave a serious void if he left." **am**

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