

Thailand

International Conference on  
**Pensions in Asia: Incentives, Compliance and Their Role in Retirement**

**Pension Fund, Provident Fund**  
**and**  
**Social Security System**  
**in**  
**Thailand**

By

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## **Abstract**

Thailand is one of the developing countries, which is facing an aging challenge due to demographic transformation from falling fertility rates and rising life expectancies. Currently, the retirement system is confronted with a continuous increase of the old aged dependency ratio that is pushing the government to consider reforming the current pension system.

This report describes the current retirement systems; Pillar I and II in private and public sectors as well as a summary on the alternative vehicle for individual retirement saving plan (Pillar III). A discussion on the policy option for future development is also addressed on topics of coverage, replacement and contributions, taxation issues, how to achieve real savings for retirement, administrative systems and finally issues on investment management.

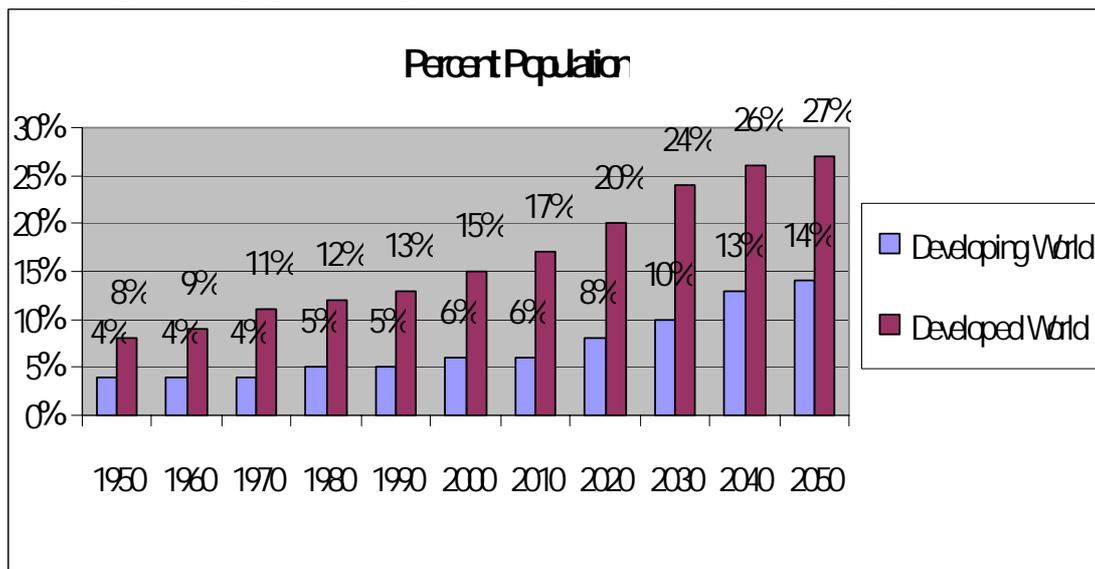
Most developing countries are just beginning to address the aging challenge, there is a few of reform models from many developed countries such as Australia, UK, Sweden and Singapore. But they are some common objectives of reductions in PAYGO benefits, providing adequate pension benefits to workers at the end of their careers, and universal retirement system to cover all labor force.

The purpose of this report is to summarize the challenge for Thai retirement system. Section 2 of this paper will outline the demographic transformation in Thailand which will restructure the Thai economy. Section 3 explains the current and development of pension system in private and public sector. Section 4 presents the interim solution to manage the pension coverage though voluntary defined contributions products. And section 5 discuss on future policy option and the challenges for better implementation.

## 1. The world is aging

The world is aging is the result of two long-term trends: falling fertility rates and rising life expectancy. Over the next few decades, it will restructure the economy. Thus, all governments everywhere will sooner or later have to consider pension reform is the high priority agenda in their countries because it will put enormous pressure on government budgets and national economies.

.Percentage of the population aged 65 and over: History and UN projection



source: UN (2001)

Today in the developed world, 15 percent of the population is elderly. By 2030, according to the latest UN projections<sup>1</sup>, the share will be closing in on 25 percent; by

2050, it will be closing in on 30 percent. In Japan and some European countries, the share will be passing 35 percent. Developing countries remain much younger but we could anticipate that in a few decades they will be in the same situation as developed countries

In the OECD countries, they are looking for solutions to deal with the increasing demographic burden and place pension financing on a financially sustainable track to maintain prosperity in ageing societies. In the developing countries of Asia, where pension systems are limited in size and scope, it is even worst in somewhere with the absence of social safety nets.

## **2. The Demographic Transformation in Thailand**

The fact that the world is aging will drive each country to rethink about their retirement system, and Thailand is no exception.

### **2.1 Falling Fertility Rates**

In 2003, the population in Thailand was about 64.27 million. It was 54.55 and 44.84 million in 1990 and 1980 respectively. The population annual growth rate between 1970-1990 was 2.1 %, this has dropped in the last decade (1990-2001) to 1.4% due to the success of family planning program. The total fertility rate has dropped from 6.4% in 1960<sup>2</sup> and 2.36% in 1990 to 1.88% in 2000.<sup>3</sup> With the number of population increasing and the falling of fertility rate, the country will face the situation of less children and more elderly population. In the last 30 years, government was worried about over population. Today, they should start to worry about depopulation in the next 30 years.

When the ratio of people in the older age group increases, the number of death in each year also tends to increase. As a result, it can be estimated that the increase in the population growth (a number of birth exceeds a number of death) per year has a tendency to decline to a level where the number of death is comparable to the number of birth. This will cause a stable number of populations without any increase in the next 30 years. At that time, the number of Thai population will become stable at no more than 75 million.<sup>4</sup>

Table: Number of Thai Population

Year	Number of Population
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1911	8,266,408
1919	9,207,355
1929	11,506,207
1937	14,464,105
1947	17,442,689
1960	26,257,916
1970	34,397,374
1980	44,842,540
1990	54,548,530
2000	60,916,400
2003	64,265,276

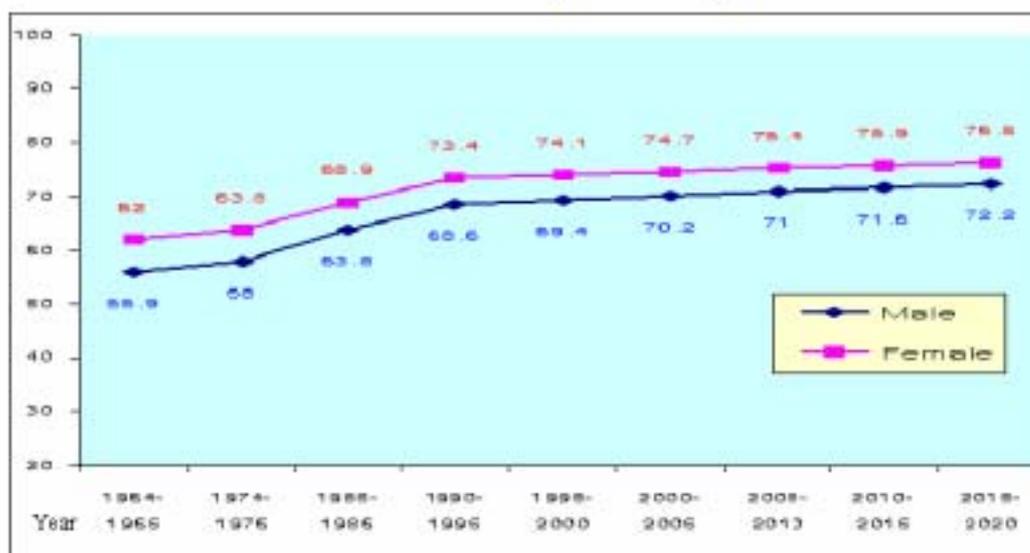
Source: National Statistical Office

## 2.2 Life Expectancy

Life expectancy for Thai has rose rapidly due to improvements in public health, nutrition and medicine. Life expectancy at birth was 59, 67, 68.55 and 71.24 years in 1970, 1990, 2000 and 2003 respectively. In 2003 females live longer than males an estimation of 73.53 years for females and 69.07 years for males. By 2020, it is projected to extend to 76.5 for females and 72.2 for males. Percentage of the old age population (age over 60) has been increasing from 4.6% in 1960 and 7.4% in 1990 to 9.5% in 2000.

When the social security system (for old aged pension benefits) was founded in 1999, the retirement age was 55 years and it still is at present. Old Aged Pension (OAP) benefits will be given to insured person at the age of 55. Thus, technically a worker who reaches 55 years could expect to live another 17 years. Although this is good news for people personally, it is bad news for the government budget.

### Life Expectancy

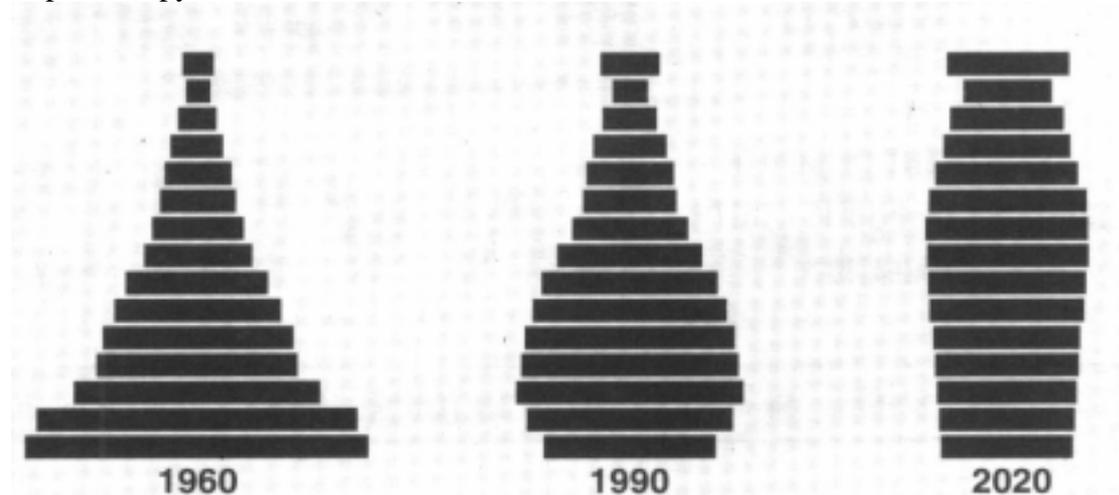


Source: National Statistical Office

## 2.3 Old Dependency Ratio

In concurrent to falling fertility rates and rising life expectancy, the retirement system is confronted with a reshaping of the traditional population pyramid, narrowing at the bottom and widening at the top. In other words, this means there is a higher number of retired beneficiaries to taxpaying workers and, this means the higher cost rate of the retirement programs is inevitable.

Population pyramids of Thailand 1960, 1990, 2020



Source: Institute for Population and Social Research, Mahidol University

The old dependency ratio for the old-age group (age 60 years and over) which increased from 8.8 % in 1960 to 14.4 % in 2000. The ratio is projected to increase further to 23.5 % by 2020. With the projected increase in the old dependency ratio, hence a projected increase in pension cost to the taxpayers is foreseeable.

Table : Age and old dependency ratio of population

Population characteristics	2000	1990	1980	1970	1960
Total population (in thousand)	60,916.4	54,548.5	44,824.5	34,397.4	26,257.9
Sex ratio (male per 100 female)	97.1	98.5	99.3	99.1	100.4
% of population aged under 15 years	24.2	29.2	38.3	45.1	43.1
% of population aged 15-59 years	66.1	63.4	56.3	50.0	52.3
% of population aged 60 years and over	9.5	7.4	5.4	4.9	4.6
Old dependency ratio	14.4	11.6	9.7	9.8	8.8

$$\text{Old dependency ratio} = \frac{\text{Number of population aged 60 years and over}}{\text{Number of population aged 15-59 years}} \times 100$$

Source: Population and housing census 1960, 1970, 1980, 1990, 2000, National Statistical office

## 2.4 Unemployment

After the economic crisis in mid 1990s the population in the labor force was 32.4 million with an unemployment rate of 4.4 % in 1998. With the economic rebound, the unemployment rate dropped to 1.8% in 2003. Which is promising for social security. However only 7.4 million workers were covered by social security and around 1.5 million in the government sector were covered by the government pension system.

Table: Total labor force

<b>Labor</b>						
<b>Indicators</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003 (Sept)</b>
Total labor force (mil. persons)	32.4	32.7	33.2	34.0	34.2	35.1
Unemployed (mil. persons)	1.4	1.4	1.2	1.1	0.8	0.6
Employment rate (%)	92.9	93.7	94.2	94.8	96.4	97.9
Unemployment rate (%)	4.4	4.2	3.6	3.2	2.2	1.8

Table: Number of Employed Person by Work Status (In thousands)

<b>Work Status</b>	<b>Nov 1999</b>	<b>Nov 2000</b>
Total	31,397.8	31,920.6
Employer	923.5	864.6
Government employees	2,567.1	2,613.8
Private employees	9,762.3	10,247.4
Own-account workers	9,752.9	10,104.3
Unpaid family workers	8,391.8	8,090.3

Source : National Statistical office

### **3. Development of Pension System in Thailand**

The first pension system in Thailand was founded during the reign of King Rama V for the public sector with the enactment of the Pension Act in 1902. This was upon the expressed wish of the King that government officials should be well-taken care of with respect to welfare and security after retirement. Under the reign of King Rama VII, the Act was amended and pension rights belong to government officials only.

In 1939, the Act was replaced by two new Acts; one for civil servants and the other for military servants. In 1951, the new Pension Act superseded the previous one and it is used for the central government officials until now.

For the private sector, the earliest attempt to establish a social insurance scheme in Thailand was in 1932, set in the context of a national economic policy. However, the subsequent political environment prevented this program from being implemented even when the first Social Security Act was passed in 1954.

In 1973, the government put the employment injury insurance into force by the Announcement of the Revolution Party No. 103, which offered protection to workers for work-related sickness and injury. In 1990, the Social Security Act was passed and the Social Security Office was established by the end of that same year. It later became part of the Ministry of Labor and Social Welfare.

The scope of protection offered by the social security scheme is growing, both in terms of the eligible group of workers who are covered by the scheme, and the type of protection benefits that they are offered. At present the benefit consist of:

1. Sickness of Injuries Benefit consist of medical treatment free of charge at the registered hospital and cash benefits due to sick leave
2. Maternity Benefit consist of cash benefit and lump sum for delivery.
3. Invalidity Benefit consist of medical treatment and cash benefit
4. Death Benefit consist of funeral grant and survivors allowance.
5. Child Allowance, monthly allowance is paid to the first two children of the insured with under 6 years old
6. Old Age Benefit: lump sum or pension. The insured person will receive old-age lump sum benefit or old-age pension benefit.
7. Unemployment Benefit was in force on January 1, 2004. The laid-off insured person will receive an allowance of 50% of wages for not more than 180 days within 1 year.

In September 1990, the scheme initially covered only establishments with 20 or more works throughout the country. In September 1993, the scheme extended the coverage to establishments with 10 or more workers. And in April 2002 up to present, the scheme covers establishments with 1 or more workers.

### 3.1 Current Thailand's Pension System

Thailand currently has a few system covering different sectors of employment. The Thai pension system can be categorized into two sectors; public and private sectors. Within both sectors there are some groups of workers that are not covered by any mandatory pension system.

There are 2 voluntary defined contributions (Pillar III): Provident Fund and Retirement Mutual Fund (RMF) that similar to 401(k) and Individual Retirement Account (IRA) in US respectively. However central government employees, government related organizations employees are provided with Provident Fund according to the government policy. Therefore, this voluntary defined contributions (Pillar III) in this case can counted as implicit mandatory defined contributions (Pillar II) as well.

State enterprises used to have defined benefits pension, due to government policy of privatization, some of state enterprises had replaced the original pension system to provident fund, therefore either the workers receive the defined benefits pension or have their own retirement account with provident fund

It is obvious that the Thai pension system contains gaps if it is measured against the World Bank's recommended multi-pillar system. The table below summarizes the types of schemes offered in Thailand.

Pension system in Thailand

	Mandatory Defined Benefits	Mandatory Defined Contributions
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	Pension	Lump sum	Pension	Lump sum
Central Government Officials	Original Pension		-	GPF
Central Government Regular Employees		Original Pension		Provident Fund*
Central Government Temporary Employees	-	-	-	-
Local Government Officials	Original Pension		-	-
Government-related Organization Employees	-	-	-	Provident Fund*
State Enterprise Employees	Either Original Pension or Provident Fund**			
Salary-type Employees	Old-Age Pension		-	-
Wages-type Employees	Old-Age Pension		-	-
Self-employed	-	-	-	-
Informal sector	-	-	-	-
Teacher and headmaster in Private School	-	-	-	Private Teachers' Provident Fund

\* by government policy

\*\* due to some state enterprises had replaced the original pension with provident fund

### 3.1.1 Private Sector

#### 3.1.1.1 Old Age Pension Fund (OAPF)

A compulsory defined benefits old age pension scheme for private sector employees was introduced on 31 December 1998. The scheme was enacted by the Security Act 1990 amended by Social Security Act (No. 2) 1994 and Social Security Act (No3.) 1999 and is administered by the Social Security Office.

The scheme called “Old Aged Pension Fund” (OAPF). operates under the Social Security Fund – this is regarded as being the only Pillar I scheme for private sector in Thailand, although its coverage of Thai population is still quite limited. The scheme was established in 1990, and at the early stage only sickness, maternity, invalidity and death benefits was provided to the insured persons funded by tripartite contributions of 1.5 per cent from each of employees, employers, and the government.

- **Coverage**

Only all establishments with 20 or more employees were eligible in 1990 for social health insurance benefits, with the exception of old age pension benefits. The old age pension benefit was added later in 1999. The coverage was expanded to 10 and after 1 in September 1993 and April 2002 respectively. As of the end of 2003 the scheme had around 7.4 million insured persons, although this was expected to be over 10 million insured persons. Thus translates that there is currently around 70-80% compliance rate. Furthermore,

coverage is still absent in self- employed, informal sector and teachers in private school for this basic social safety net.

The insured person is an employee who starts working at the age of not under fifteen and not over sixty years old in an enterprise with 1 or more employees. However the Social Security Act is not applicable to:

1. government officials and regular employees of the central administration, provincial administration and local administration except for temporary employees,
2. employees of foreign governments or international organizations,
3. employees whose employer's office is in the country but are being stationed aboard,
4. teachers or headmasters of private schools under the Private School Act,
5. students, student nurse, undergraduates or apprentice doctors who are employees of schools, universities or hospital,
6. other employees as prescribed in the Royal Decree.

### Social Security Fund:

#### Number of Insured Persons and Member of Establishments : 1994-2003

November Year	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Insured Person.	4,961,700	5,249,742	5,595,742	6,151,270	5,578,893	5,659,871	5,844,248	5,884,652	6,894,191	7,412,865
Establishment	64,663	73,735	82,074	90,618	93,025	99,620	107,117	110,561	299,127	322,706

Source: **Social Security Office**

- **Contributions**

The Social Security Act defines the combined contribution rate for old age pension and child allowance to be collected from 3 parties: employer, employee and the government, at a rate which altogether does not exceed 9 % of wage (employer 4 %, employee 4 % and government 1%) However, government contributions are funded for child allowance, and only part of the employer and employee contribution will be funded for the old age benefits.

Like most of all the social security schemes in the world, the actual contribution rate for the old age pension had gradually increased from 2 % (employer 1 %, employee 1 %) for 1999, and had been risen to 4 % (employer 2 % , employee 2 %) in 2000, and in 2003 rose again to 6 % (employer 3 % . Employee 3 %) and this contributions rate is still being used at this moment.

All of these contribution rates are subject to a minimum of 1,650 Baht per month and ceiling of 15,000 Baht per month or 180,000 Baht per year. In

addition the Social Security Act provided for the maximum and minimum wages used to calculate contributions to be adjusted by Ministerial Regulation.

The contributions paid to the Social Security Fund by employers and employees are tax deductible and the benefits payable is tax exempted.

- **Eligibility**

The qualifying conditions for receiving a full pension are:

1. The insured person must reach 55 years of age and quit their job.
2. The insured person has paid contributions for not less than one hundred-eighty months irrespective of whether the period is consecutive.

Otherwise they will qualify to receive a lump sum from OAPF.

- **Replacement rate**

The old age pension scheme offers a benefit under a partially funded defined benefit approach. The replacement rate is calculated under these conditions:

*Old age pension*

1. In case the insured person has paid contributions for 180 months, he/she could receive old age pension benefits at the rate of 15% of average wage of the last sixty months which is used as the base of contributions calculation before termination of being an insured person.
2. In case the insured person has paid contributions for over 180 months, he/she will receive old-age pension at the rate of 15% and 1% per additional twelve months of contributions above 180 months.

The insured persons will start to receive their pension when they have reached 55 years. With regards to the old age pension which was in forced in 1999 and the condition of contributions must not be less than 180 months. Therefore, there is no pension which will be payable until 2014. At that time, the annual cash surplus of contributions over expenditures is estimated to be approximately 1.5 trillion Baht<sup>5</sup>

*Old age lump sum*

1. In case the insured person has paid contributions for less than 12 months, he/she shall be paid old-age lump sum benefit equal to the amount of contributions that he/she has paid for old-age benefit.
2. In case the insured person has paid contributions for more than 12 months, he/she shall be paid old-age lump sum benefit equal to the amount of contributions that he/she has paid for old-age benefit plus interest at the rate set up by the Social Security Office.

3. In case the insured person died within 60 months since the entitled month for old-age pension, he/she shall be paid old-age lump sum benefit equal to 10 multiple of the last old-age benefit before death.

- **Minimum Pension**

It was stated in the Ministerial Regulation relating to the Social Security Act 1990, that the amount of pension must not be less than a certain minimum pension. This minimum rate is prescribed by SSO based on a consideration of the economic situation at the time of payment

- **Investments**

The current investment guidelines for the OAPF comply with the regulations of the Social Security Sub-Committee on investment. The Sub-Committee on Investment consists of employers, employees, government representatives and highly experienced investment experts. This Sub-Committee Provides recommendations to the SSO, who then request approval from the Social Security Committee, in compliance with the Ministry of Finance guidelines.

In 2000 OAPF entirely invest in Thai bonds. In December 2003, size of the OAPF is around 117.39 billion Baht. The assets of the OAPF are invested by Social Security Office most in Thai bonds, there is only 2.80% in equities and 3.92 % in State owned enterprise equities. The major proportions of investment are as follows:

1. State Enterprises / Commercial Banks	23.99 %
2. Government Bonds /Government Guarantee	37.17 %
3. State Enterprises Bonds	10.71%
4. Equity	6.72%

As well as other Thai-based investors, the OAPF is currently unable to invest offshore directly.

### ***3.1.1.2 Private Teachers' Provident Fund***

Private Teachers' Provident Fund is the mandatory defined contributions for teachers and headmasters of private schools under the Private School Act. The contributions are 3% of salary from teachers or headmasters and 3% of salary from school owners while the government contributions are 6% of salary. The investment return from government contribution will not distribute into individual account, but it will retain in a separate account and is for the use of the welfare benefit for the teacher or head mater and their immediate family.

The teachers or headmaster will receive payment in lump sum when they resign from their work with a vesting period of 5 years of service. With this condition most of the teacher will resign at 5 years of service and be re-employed.

At present, there are 127,034 teachers and headmasters in 7,688 private schools with a fund size of 7,718.13 million Baht, manage by the Ministry of Education.

By Act, they are permitted to invest only in government and state owned enterprise bonds or deposits in state owned enterprise banks.

### **3.1.2 Public Sector**

Government officials are well taken care of with a generous Pillar I system with respect to their safety net for retirement. They are divided to central government and local government.

#### **3.1.2.1 Central government**

Government officials are not covered by the OAPF, they are required to be members of the Government Pension Fund (GPF). GPF have two Pillars structure, the first is an unfunded defined benefit paid out of the fiscal budget, the second is a funded defined contributions from the officials (employees) and the government (employer). At the time the second Pillar was introduced on March 27, 1997, the government officials were given an option to join and if they chose not to join GPF, they will be entitled for the original pension PAYGO system.

##### ***The original pension for central government official***

With regards to Government Pension Act 1951 which covers central government officials, the officials will immediately receive pension or gratuity regards to their years of service and their age at the point they terminate their service. This is a PAYGO system.

The qualifying conditions for receiving a pension are:

1. The retiree must have at least 25 years of service or
2. The retiree must have at least 10 years of service with the termination of service in under these following conditions: old age (over 50 years), permanent disability, and work abrogation.

However retiree who is eligible for pension would be able to choose gratuity.

The qualifying conditions for receiving a gratuity are:

1. The retiree must have at least 10 years of service or
2. The retiree must have at least 1 year of service with the termination of service under these following conditions: old age (over 50 years), permanent disability, and work abrogation.

If they choose to receive pension at the flat-rate basic, benefit is equal to last month salary times 2% accrue every year of service. If they choose to take gratuity they will receive lump sum payments equal to their last month salary times number of years of service. With regards to unfunded nature of the scheme which implies that the ability to meet this future obligations. However, the government is setting 3 times of fiscal budget for the pension expenses separates into reserve account and

invests in Government Pension Fund in order to cover pension payments to pensioners in case of financial crisis.

### ***The Government Pension Fund (GPF)***

In 1996 the parliament passed the Government Pension Fund Act 1996, in order to reform the central government retirement system by introducing the defined contributions Pillar II for the central government officials in tandem with the previous Pillar I system.

The Government Pension Fund ("GPF") the first public sector defined contributions fund in Thailand was founded in in March 1997 with two major points have been changed.

1. The original pension benefit is reduced by using average of 60 months salary rather than last month salary and the ceiling is not more than 70% replacement rate. Therefore the pension is reduced by 12-15 %. However the total replacements increase from the retirement saving from GPF.
2. The Act mandates the government to accumulate the reserve fund equal to 3 times of fiscal budget for gratuity and pension payment, implying that the pillar I is no longer fully unfunded system.

As a mandatory scheme every government officials must join the scheme except those who are in service before March 27, 1997 and choose to stay with the old pension scheme. If they choose not to join the GPF, they will be eligible for pension according to Government Pension Act 1951 only. In December 2003, GPF has 1.2 million members with the fund size of 230,000 million Baht (US\$ 5.5 Billion)

The individual accounts consist of:

1. Member contributions account, this contribution is 3% of salary.
2. Government contributions account, this contribution is equal to member contributions (3% of salary).
3. Compensation account, this contribution is from the government account is 2% of salary
4. Initial account, it is a one time government contributions, this account has a formula of calculation, it is equal to the compensation contribution and expected return for the members who are in service before March 27, 1997 would receive since they work with government until March 27, 1997.

The members will immediately receive their defined benefit pension or gratuity from government budget, while they will remit member and government contributions from GPF. In addition, they will receive the compensation and initial account if they choose to receive pension from the government.

The members' contributions are tax deductible and the benefit payments are tax exempted.

- **Investment**

The investment policy for the GPF complies with the Ministerial rules. There is an Investment Sub-Committee to review and recommend investments to the Board of Directors.

The ministerial rules state that investment must comprise of more than 60% in low-risk security and less than 40% in higher- risk assets. In this regard, we note that the risks in ministerial rules would mean credit risk only. At present, GPF's investment is managed 70% in-house and 30% by external fund managers. The Portfolio consist of :

1. Fixed income	80%
2. Equity	15%
3. Real estate	3%
4. Alternatives Investment	2%

GPF has also adopted the corporate governance practice into their investment policy as they believe good corporate governance would contribute to the long term investment returns.

### **3.1.2.2 Local Government**

The local government official is eligible for pension or gratuity similar to Pillar I system in 1951 of central government only. However the system is a partial funded system with contributions coming from 1% of fiscal local government budget every year. This fund is managed by the Ministry of Interior, and there is no actuarial test to see if the fund is over liability or not.

### **3.1.2.3 Government Permanent Employees**

Government employees are not covered by OAPF, they have two Pillar structures, the first is the gratuity and the second is provident fund.

#### ***Gratuity***

The permanent employees will immediately receive a gratuity from the fiscal budget in accordance with the ministry of Finance's Regulations on Employees, Gratuity 1976.

#### ***Government Permanent Employees Provident Fund (GPEF)***

The government permanent employees are eligible to the GPEF. This fund was arranged according to the Provident Fund Act for permanent government employees who are not government officials. The permanent government employees make voluntarily monthly contributions at a rate of 3% of salary, and the government matches these contributions. As of December 2003, there are 161,100 permanent government employees covered by the fund. The total value of the fund, as of the end of 2003, is 5,089 million Baht (US\$128 million)

#### **3.1.2.4 State-Owned Enterprises**

Some of the state owned enterprises will provide pension and gratuity for their employees. However the government would strongly encourage them to transform these defined benefit system to provident fund.

At present, 74 state owned enterprises have provident fund coverage according to the Provident Fund Act, 1987. The total state owned enterprises' provident fund, as at the end of 1999, is valued at 10,213.6 million Baht (US\$270.8 million). Currently, there are about 294,979 state enterprise employees covered by the provident fund with funds size is 118,968 million Baht (US\$ 2,974.2 million). Under this scheme, the employees of the state enterprises will receive a lump sum from the provident fund.

#### **3.1.2.5 Government Related Organizations**

Government related organizations are the independent entities which are not state owned enterprise. Most of them will provide provident funds to employees on voluntary basis.

### **4. Pillar III is in Action**

In fact, There are real Pillar II by law only the GPF and the private teacher fund. Beside that the provident fund was used as the vehicle to provide Pillar II benefits in the public sector under the government upholding although the provident fund is not mandatory by law.

At present there are 2 products of Pillar III benefits: provident fund and retirement mutual fund (RMF).

#### ***Provident Fund***

The Provident Fund was enacted in 1987 to encourage private sector employees to save for retirement. The fund is a voluntary defined benefit and is arranged upon agreements between employers and

employees to set the Fund Committee that oversees the provident fund. The committee is comprised of representation from employer and elected representatives of employees. Then the committee will choose the fund manager. The scheme regulatory authority is under the Securities and Exchange Commission (SEC).

Employee's contributions must be at least 3 per cent of wages but must not exceed 15% of wages. Employer's contributions must not be less than the employee's contributions. In Thailand, Provident Funds are always established in large enterprises. As of December 1999, provident funds covered 1.03 million employees in 4,005 enterprises. And total value was estimated at 182,735.7 million Baht (US\$4,848.8 million). At end of 2003 the provident fund covered 1.41 million employees in 5,760 enterprises with total fund size of 287,329.3 million Baht (US\$ 7,183.23 million)

The employees will receive lump sum proceeds at the time of their resignation or retirement. Segregation of the fund as separated juristic person from the company, the plan sponsor, is required.

The contributions paid to the provident fund by employees and employers are tax deductible and the benefit payment is tax exempted.

The SEC had introduced new regulations permitting provident fund managers to offer the members investment choices. The regulation states that a conservative option must always be offered. In addition other options can be offered, but the fund manager must specify clear investment policies for each option.

#### ***Retirement Mutual Fund (RMF)***

The concept of the retirement mutual fund (RMF) has been established in Thailand with effect from the end of March 2001. This fund aims to provide a means of the voluntary retirement savings to those employees who are not in the provident fund or who want to make the additional contributions.

Fund manager will provide a few RMFs with the different risk profile, the investor can switch his/her investment from one fund to the other funds or even to the other fund managers. However he/she will not be able to withdraw the fund until he/she attains retirement age (55 years) without tax penalty.

As of December 2003, the total funds are 8,336 million Baht (US\$ 208.4 million)

The RMF are intended to subject to more favorable taxation regime.

## 5. Policy option for the future

Two most important issues of retirement savings are the universal coverage and the adequacy of replacement.

### 5.1 Coverage

Although the government realizes the importance of providing its population with safety net for old age, the national scheme constituting OAPF and provident fund in private sector and original pension, GPF and provident fund in public sector, at this level of implementation does not provide universal coverage.

**In private sector**, less than 5% (1.4 million) of the Thai labor force (32.5million) are members of provident funds. Only 22.8% (7.4 million) of total private labor force are covered by OAPF. And 127,034 private teachers and headmasters are covered by the private teachers' provident fund. By estimate around 24 million persons have no coverage. Two issues must be addressed, firstly to extend the coverage of OAPF to the self-employed and informal sector eventually. Secondly, to establish the mandatory provident fund that will act as a Pillar II for Thailand

**In public sector**, most of the government employees are covered by either pension or GPF or provident fund except temporary employees. We would recommend they should be included in the OAPF coverage.

### 5.2 Replacements and Contributions

**In private sector**, assuming that everyone are covered by OAPF and provident fund, according to the World Bank's study, the wage replacement rate of 60-70 % of last month salary is defined as adequate old age income, thus a goal to be achieved. As for the private sector employees, the basic OAPF replacement alone is not sufficient, if a worker starts work at 25 years and retires at 55 years, he or she will receive pension payable at 30% replacement rate. Therefore the provident fund needs to generate an additional 30-40% of replacement rate which means the contributions will be 4% form each employees and employers.

However, there is the result of actuarial analysis under ADB technical assistance using the World Bank's PORST model showed that OAPF reserve will have positive cash flow until 2026. Thereafter, cash flow will be negative. Furthermore, the future payroll contributions plus reserve allow the system to remain solvent until 2049, at which time the fund is bankrupt and unable to meet its benefit obligations to pensioners.

There are a number of approaches that could be undertaken to address this estimated shortfall:

1. Increase contribution rates or
2. Reduce benefit levels to less than 1% per annum or
3. Increase the retirement age

In order to cope with the shortfall, the government need to do either one of the recommendations or a combination of the above. Otherwise if the government do nothing any shortfall will be a burden to taxpayers.

It is important that, whatever approach is undertaken it has to be affordable to Thailand. There is no point in introducing any retirement savings arrangement that places considerable burden on Thai companies and potentially makes them uncompetitive. Thus, the government should establish the mandatory provident fund and introduce the contribution rate of a few percent and gradually increase in the following years.

**In public sector**, government officials opting for pension (rather than gratuity) effectively enjoy a 'Super Pillar I' scheme which gives them wage replacement rate of about 70 % with additional of GPF for the central government officials. The government related employees and state owned enterprise employees will have the replacement rate over 60% from the total contributions more than 10% of salary. Furthermore, the retirement age of the government employees is 60 years.

### **5.3 Taxation Issues**

With regards to the tax system in Thailand, the retirement savings benefit from tax incentives are currently subject to an EEE regime. That is, contributions to the funds are tax deductible up to a limit of 300,000 Baht per annum (the first "E"), the investment income of the fund is not subject to tax (the second "E") and the retirement benefits payable from the fund are not taxable as income to beneficiaries (the third "E").

Most retirement saving systems in the other countries are EET since the best approach for retirement savings are deferred income. While the contributions reduce the capability to pay tax and that should be recognized by tax exemptions. While the savings are growing in the fund they do not affect an individual's capability to pay tax so earning should not be taxed. When the benefits are being paid they increase the capacity to pay tax and can be assessed on the basis of the current personal income.

The EEE system is the most prevalent currently use in Thailand. However the benefit payable (last E) must be paid in lump sum, otherwise it is taxed except for pension payable from OAPF. Therefore, this tax system discourages retirees to keep their retirement savings for their lifetime after retirement. Furthermore, they need to decide how to manage their lump sum to provide income in retirement.

Without knowing how to manage the lump sum payable, this can create the longevity risk. Therefore, in theory, the retirees can overcome this risk through the purchase of a life annuity, thus this will be the option for retirees to shift the longevity risk to the life insurance company.

However, there is an obstacle to develop life annuity product in Thailand due to 2 reasons. Firstly, Tax Code generally defined not over 60% of premiums are reserves which are tax deductible. Secondly, The concept of annuity is not well understood in

Thailand. Therefore, an education program would need to be undertaken to explain how the annuities work.

An important consideration is that the government needs to ensure that the appropriate environment is in place, one that encourages annuity payment gradually by phase into the EET regime, and this regime should be applicable to all Pillars. With regards to the option for retirees, life annuity product will need to be developed by addressing the taxation issues to allow for decent reserves to be tax deductible.

#### **5.4 Mechanism to Achieve Real Savings for Retirement<sup>6</sup>**

Although Thailand has established provident fund, GPF and OAPF to some extent, the system still lacks the mechanism to keep those savings for retirement. There is no incentives to keep the saving until retirement age, defer, portability and gradual benefits payments, which are the key characteristics to achieve such objectives, are still absent in the Thai system.

- The lack of incentive to keep saving until retirement age, in provident fund and in GPF the laws define that the member must take the lump sum payable from the fund when they leave their work. With two reasons, first, the tax system does not encourage the workers to keep the benefit with the fund due to EEE regime. Secondly, there is no vehicle to defer the savings in the fund or rollover the benefit to the other retirement savings funds.

While the existing provident fund regulations do not facilitate the portability of the funds, membership must also be promptly terminated upon resignation. The stipulation on payment as elaborated above makes transferability to new employer's sponsored fund is not possible except in the case of prompt availability of new job. Leaving the money with the former employer's sponsored fund is likewise not possible, even if it is within the willingness of the employees. It is highly probable that the proceeds when paid out of the fund will be spent instead of continually being set aside as savings for retirement in any form.

- The requirement on the fund administrator to pay its members lump sum within a short period after termination of membership makes gradual pension payment or choices of annuity not possible. This may cause potential problems to the retirees since they may prefer to entrust the money in the hands of professional management instead of exercising their own investment decisions, which they may not possess any expertise. The problem may even be more threatening when taking the perspective of 10 to 15 years time horizon of income management after retirement.
- GPF members are currently not allowed to make contributions above and beyond the 3 percent of monthly salary. Provident fund members are not allowed to make the contributions more than employer contributions although they are willing to make the additional voluntary contributions. The Act should be amended to let the members to make the voluntary contributions on their employer sponsor funds. However there is the existing Pillar III for

individual retirement savings called RMF which is subjected to a more favorable taxation regime.

- The pool of decision making on investment policy instead of allowing for the individual choice makes the asset allocation not optimal for risk/return profile for member under different age groups. Under the pool of investment policy, it is difficult to weigh optimally between the two objectives of capital growth and preservation of capital to suit different risk profiles.

Therefore, it needs the legislative to be changed. Additional savings, uninterrupted savings scheme, gradual benefits payments instead of one lump sum, restrictions on withdrawals except upon retirement, member investment choices, additional tax incentives for voluntary savings are issues for further reform. If amended, they would enhance the current scheme to best benefit members, and simultaneously will relieve future burden of the government and the society as a whole.

In additional, the pension system must be clearly understood by everyone paying contributions and receiving benefits. The pension system must be properly communicated to all citizens, and they must understand how to use the system to their benefit. Especially, when the define contributions schemes are provide member investment choices, it is not only the effective communication to members but also the proper education must provide to let the members understand the relation of risks and returns.

## **5.5 Administrative systems**

Administrative systems should be efficient both in terms of the collecting and distributing benefits and in minimizing waste, fraud and abuse. Efficient administration requires online systems, streamlined reporting, maintenance of accurate records, providing needed management information, allowing efficient auditing of records and benefit calculation, and encouraging voluntary compliance with contributions requirements.

## **5.6 Investment Management**

The limited supply of quality securities is a major obstacle for efficient asset allocation to achieve the objective of optimum balance of capital growth and preservation of capital. For defined contribution schemes like GPF and provident fund, diversification is prudent and of utmost importance to protect the investment from specific risks. The lack of broad range of quality instruments due to relatively small and immature financial and capital markets in developing countries makes it difficult especially for large funds to achieve efficient diversification. For GPF with a fund size in excess of 230 billion Baht compared with Thai bond market of 1,895 billion Baht and Thai equity market of 4,790 billion Baht, GPF is relatively big fund. Therefore, the flexibility to adjust its positions without causing market impacts is limited.

The inability to make cross-border investments also makes portfolios highly vulnerable to systemic risks. It is the prerogative of the Bank of Thailand to control capital outflow. For an increasingly liberalized economy, the control may need to be relaxed, in stages, after carefully weighing all the pros and cons. With the same old problem the market lacks of the investment target products. It should be noted that cross-border investment helps mitigate the undesirable trait.

Therefore, Thailand needs to develop the market of pension fund investment. Local money and capital market must be developed hand in hand. The growth in the quality and the diversity of supply should keep pace with the growth in fund size. Good governance should be enforced. Otherwise, the savings that are supposed to serve as safety net for retirement will encounter systemic risk.

Thai authorities' restrictions for cross-border investments make the local funds subject to systemic vulnerability without any buffer. As already mentioned, in the previous section, the authorities can, with caution, proceed with this issue, step by step, starting with certain limits and relaxing gradually overtime as they are doing at this moment.

### **5.7 Co-operation from All Parties Involved**

While the pension and provident funds comprise the demand side of the market, the supply side of the market must be taken into account. In addition to direct benefits to members in the building of the safety net, these funds are beneficial to the country as they promote savings, and thus help make it more self-reliant with respect to the financing of the economic growth. Although it may look like a chicken and egg issue, the supply side in terms of quantity and quality should also be simultaneously promoted to respond to the huge demand side and to keep the fund status in array.

This requires co-operation from all parties involved. The issuing companies must try hard to stay competitive in the globalize environment while adhering to good corporate governance. The related authorities, on the other hand, must set optimum regulatory framework and adequate enforcement measures necessary for the efficient development of the market.

Finally, the investors especially institutional ones must play active roles of good consumers, giving the ideas of what they want and assisting in the efficient development of the market.

Last but not least, it is also very necessary to educate fund members in the nature of the fund, the implications of fund measurement on short and long-term horizons, the risk/return trade-off of instruments and how they can be instrumental to reach their objectives of investments.

## **6. Conclusion**

It is important that the government plays a key role in laying out a master plan on pension system to ensure adequate safety net for its citizen. The multi-Pillar as

defined by the World Bank has its merit as the three pillars form an integrated pension system needed to provide individuals with adequate income after retirement.

Although certain Pillars have already been in existence in Thailand, they are not extensive enough to cover the majority of the population. There is still a room for improvement in terms of coverage, sustainability, and proper balance among sectors.

It is a positive sign that the government's efforts are now being further pursued for pension reform by establishing mandatory provident fund with the assistance from ADB. As soon as the study is completed, it is the government who must decide how and when the program is to be implemented.

It is quite natural to see some resistance from parties involved since pension programs usually require trade-off between current costs and future benefits. The government may have to sacrifice some current tax revenues to induce incentives for program participation. However, these foregone current incomes will be more than justified by less future obligations. The more each individual saves, the more self-reliance he or she would become upon reaching retirement age, and thus the less burden on the government's future budget. These, in turn, will benefit the society as a whole.

#### Notes:

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