Discussion on the National Pension Fund

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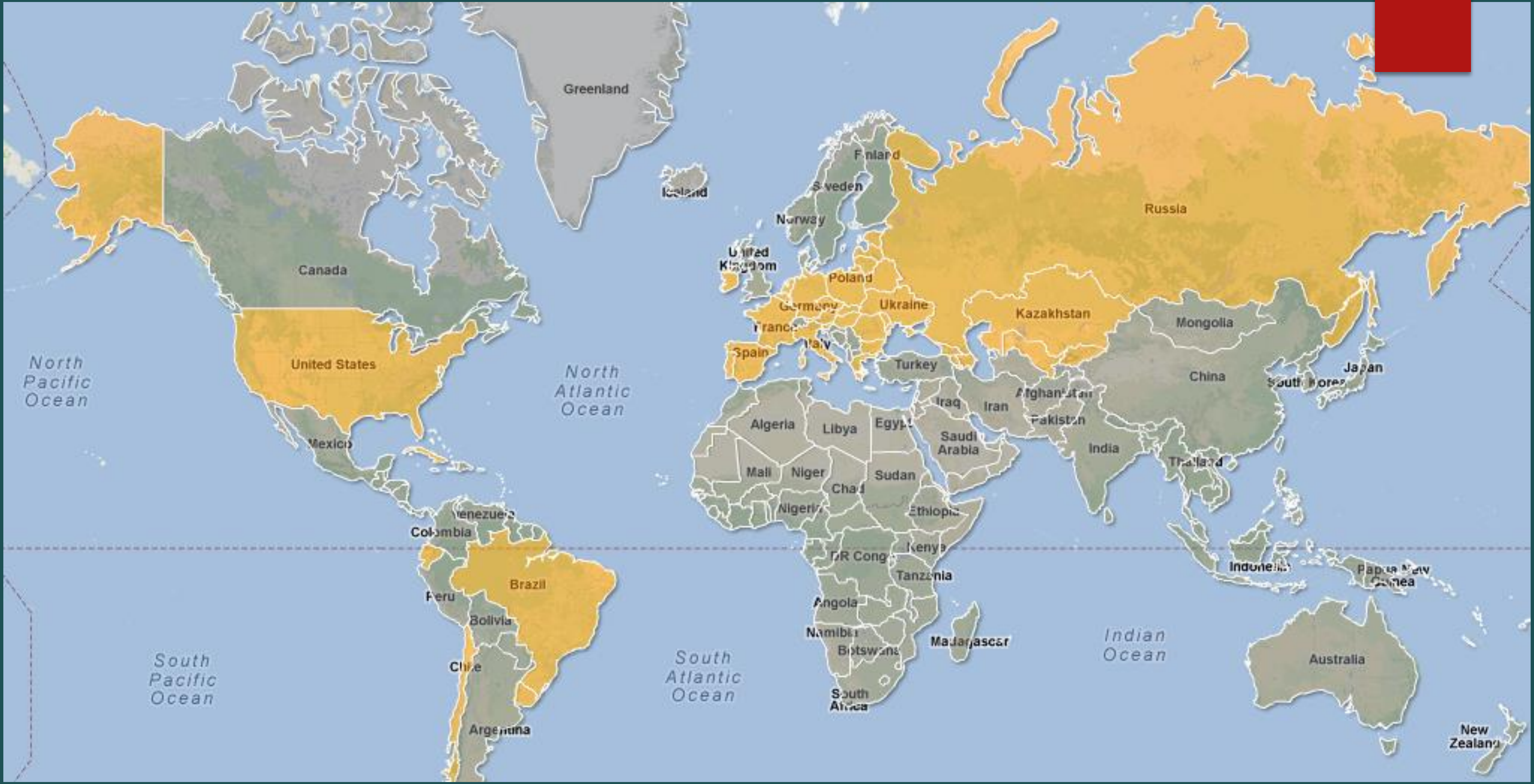
Structure of Presentation

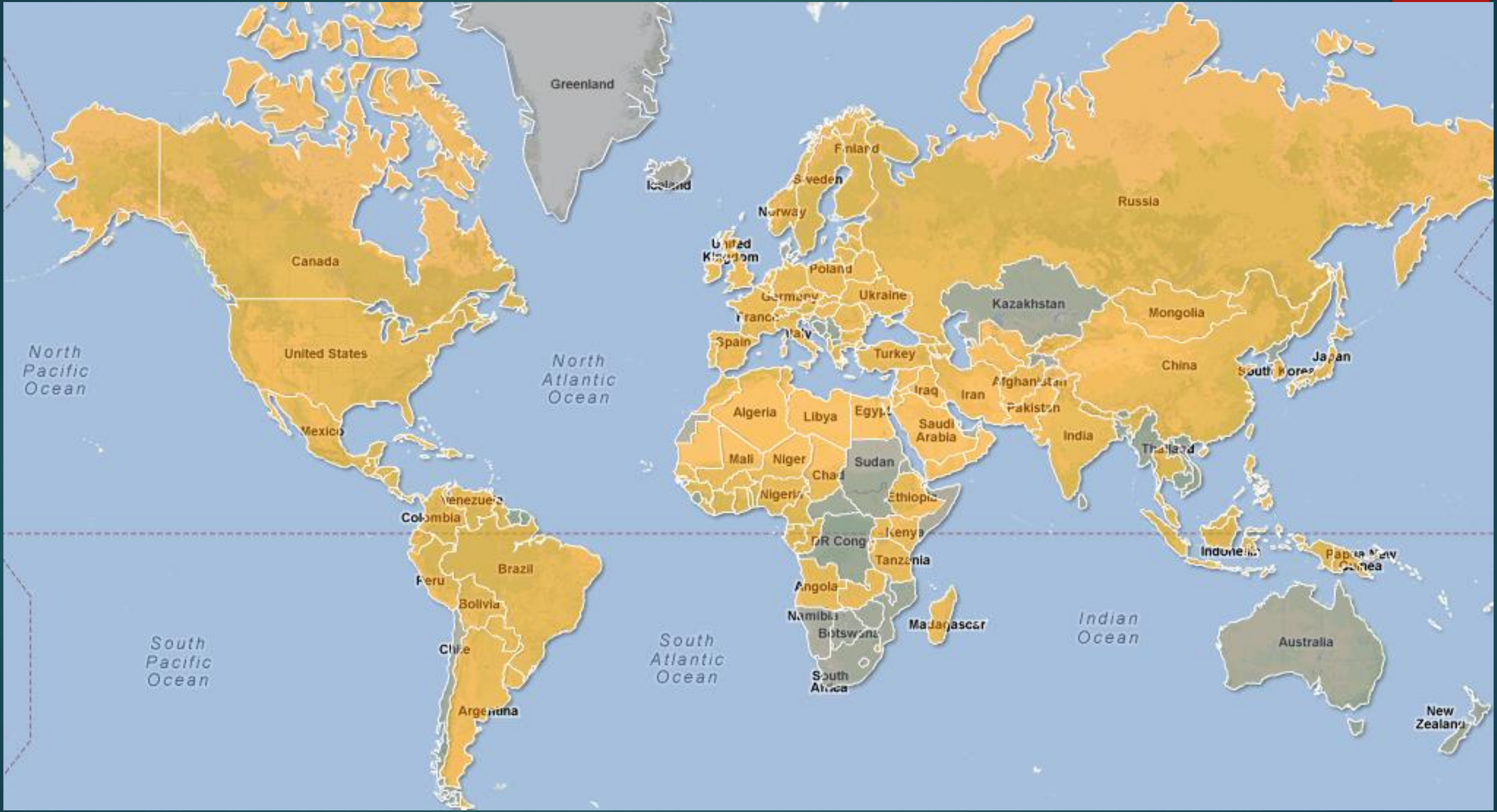
- Part 1: International experience with mandated Defined Contribution (DC) schemes
- Part 2: The role of DC schemes
- Part 3: The NPF in Thailand’s pension system

Part I
International experience with National DC schemes

Rise of DB schemes: 1935



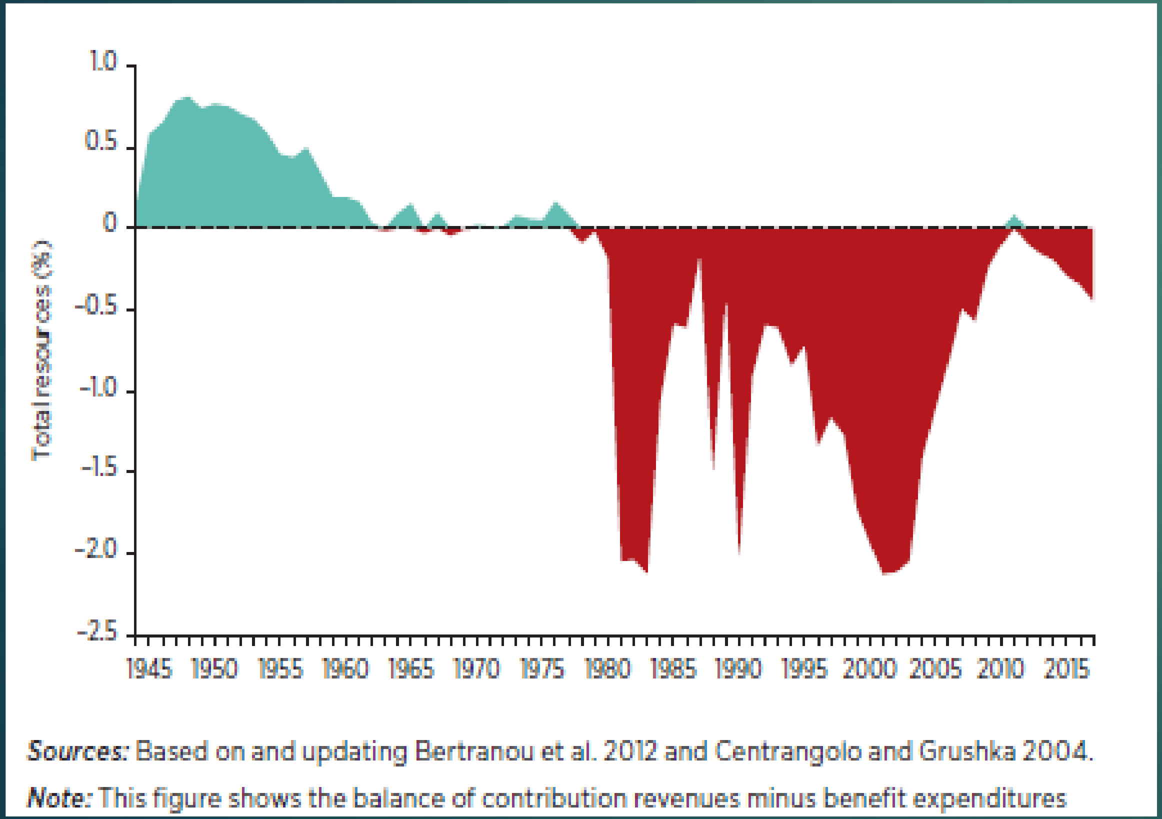
2015



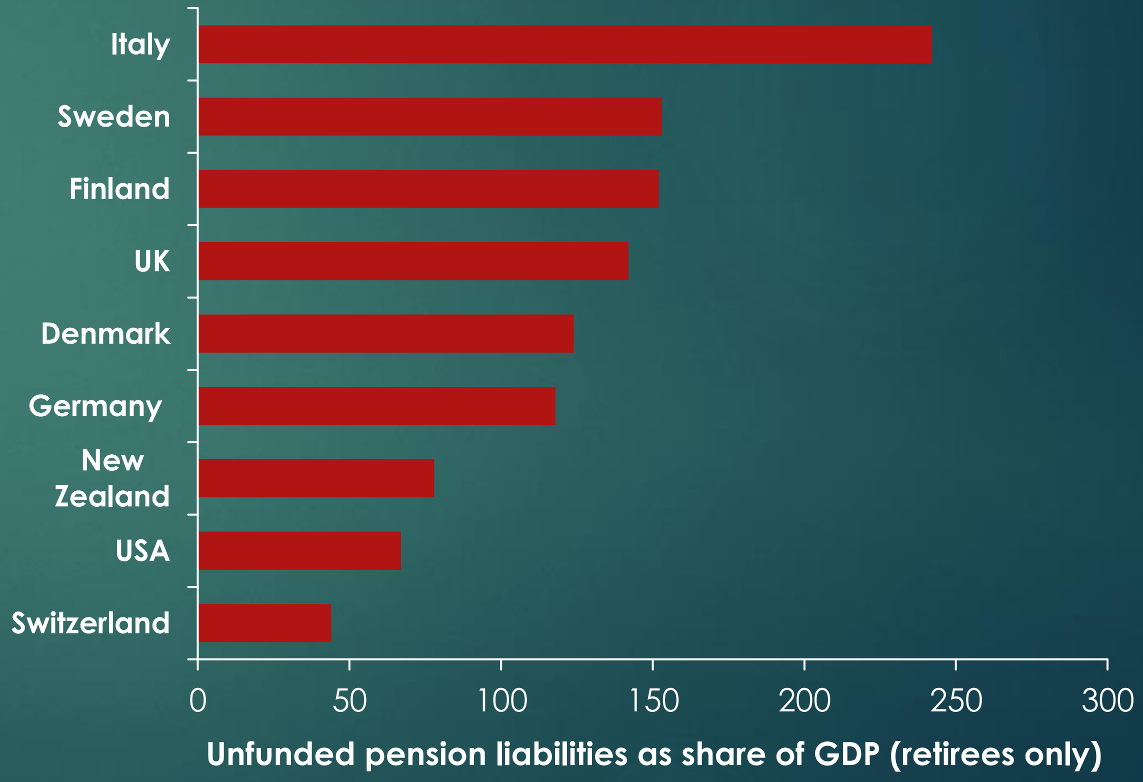
Greenland
Russia
Canada
Poland
Ukraine
Kazakhstan
Mongolia
China
Japan
United States
North Pacific Ocean
North Atlantic Ocean
Spain
Turkey
Iraq
Iran
Algeria
Libya
Mexico
Saudi Arabia
India
Mali
Niger
Sudan
Brazil
Peru
Bolivia
Angola
Kenya
Madagascar
Indian Ocean
Australia
South Pacific Ocean
South Atlantic Ocean

Mature DB schemes run deficits

PAYGO Life cycle: Argentina

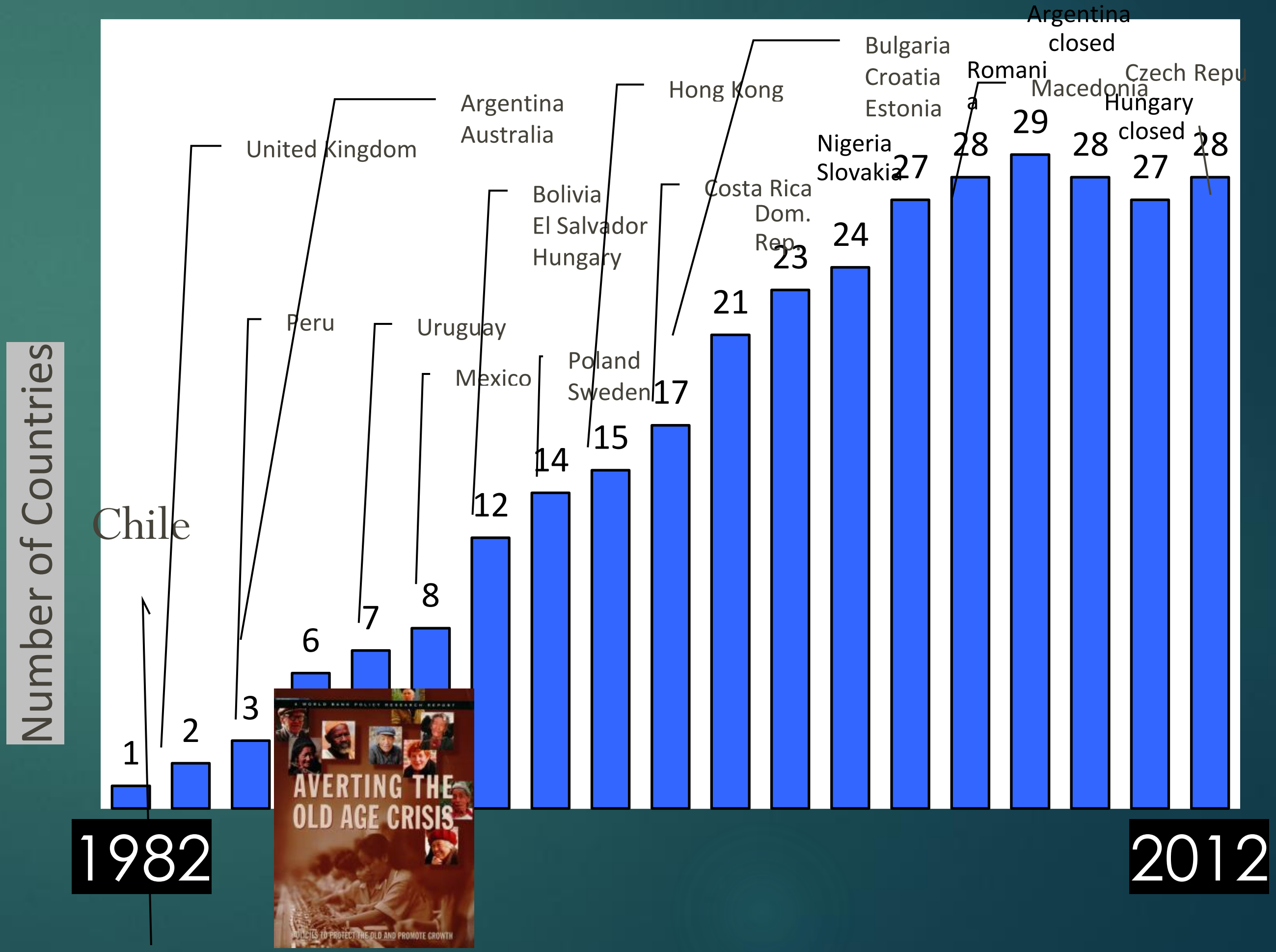


Unfunded pension liabilities



Two waves of DC schemes

- Post-WWII, independence, Provident Funds
  - India (1952)
  - Malaysia (1955)
  - Singapore (1955)
  - Sri Lanka (1958)
  - Tanzania (1964)
  - Fiji (1966)
  - Zambia (1966)
- Privately-managed DC schemes



Lessons from international experience

Publicly managed DC schemes

- Tend to invest in government bonds - safe and easy credit for government
- As a result, tend to have low investment returns
- Given size, investing in equities would raise corporate governance issues
- No portfolio choice

Privately managed DC schemes

- Require strong supervision and at least a minimal level of capital market development
- Returns are often higher but more variable especially where there is portfolio choice
- Low financial literacy – good defaults and limits to investment options are needed
- Fees can be high

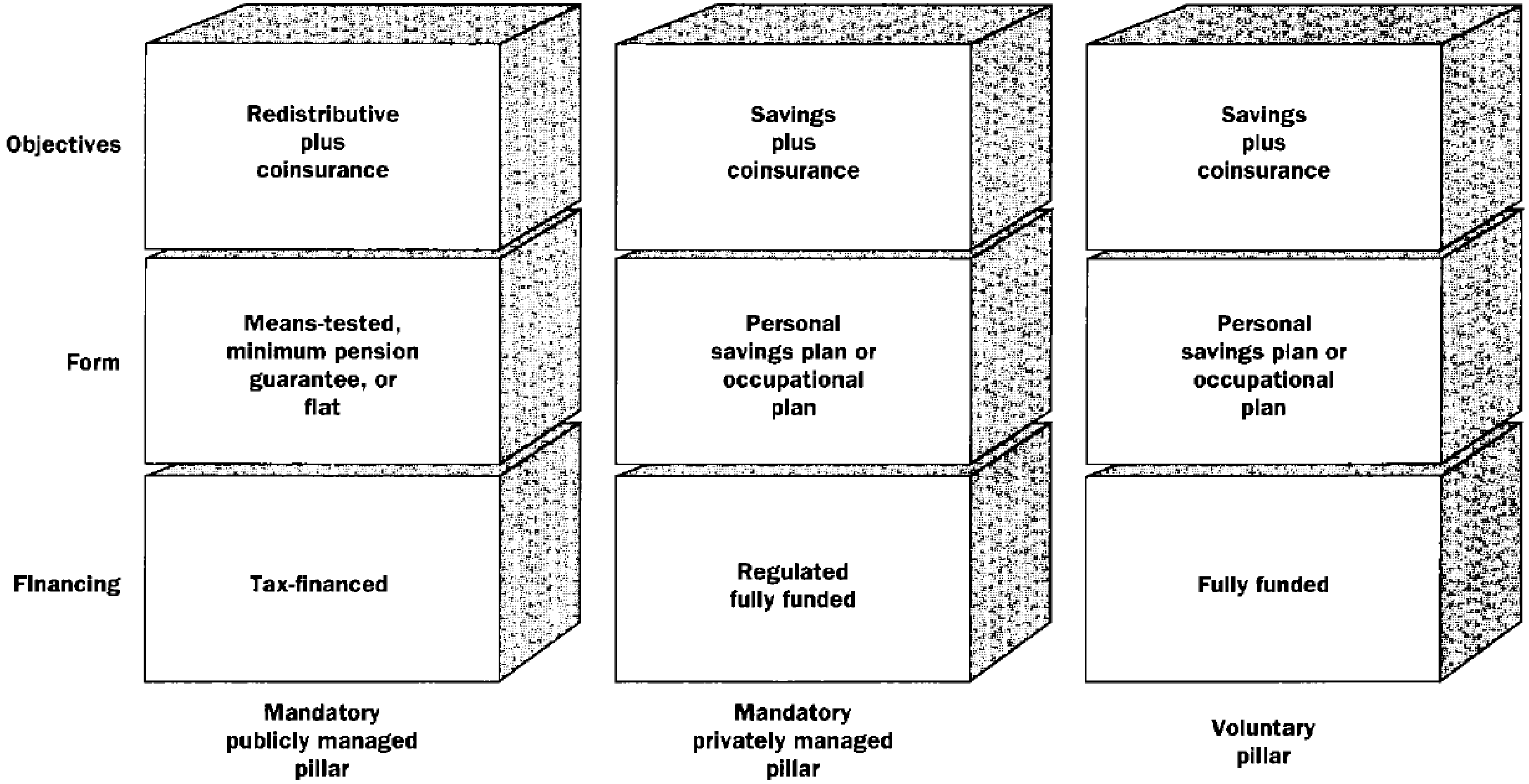
** For both types of DC scheme, it is important to ensure payout stage serves public policy objectives*

New generation DC schemes:
unbundling asset management from administration

- The models recognized that there were significant economies of scale in centralized collection and recordkeeping and that this could be separated from decentralized, competitive asset management
- Sweden introduced a national DC scheme in 1999 with worker choice of asset manager and portfolio
- India replaced a DB scheme for civil servants with a DC scheme in 2004 using an auction process for selecting asset managers that reduced fees greatly while allowing for portfolio choice for workers
- The UK introduced the National Employment Savings Trust (NEST) in 2011 that aggregates 800k small employers and offers portfolio choice

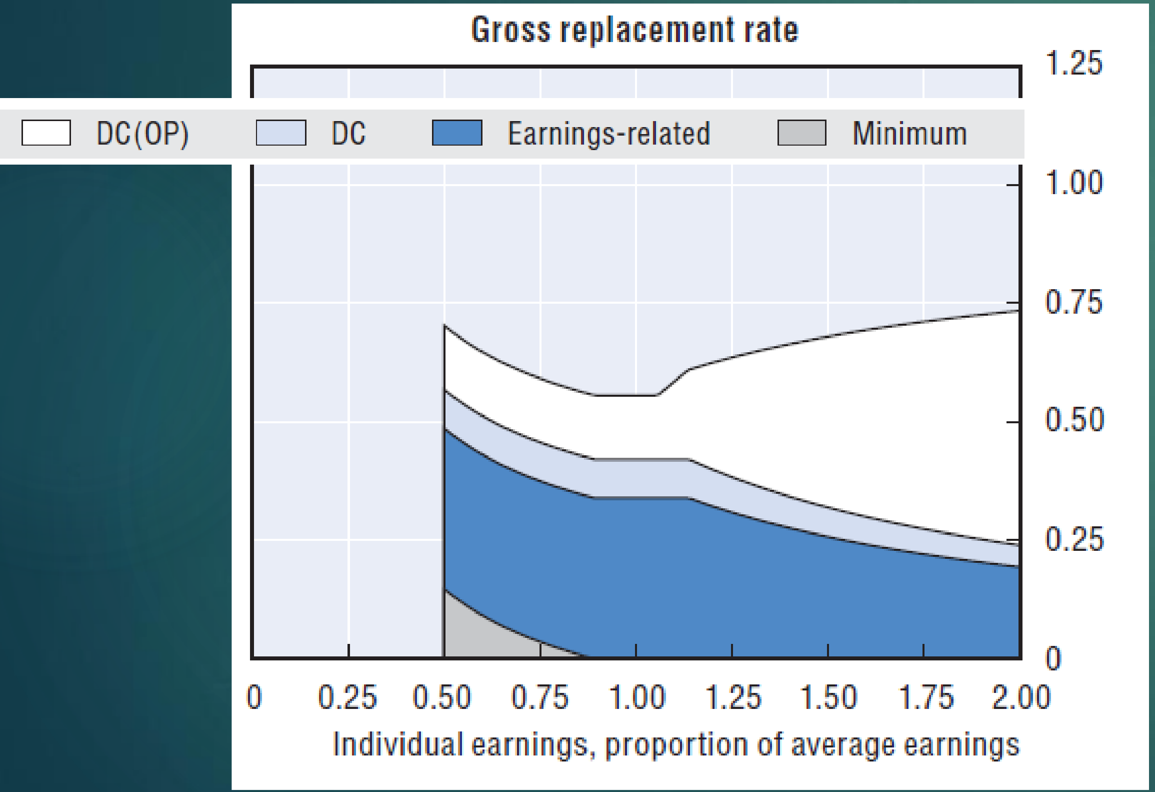
Part II
The role of DC schemes

Figure 3 The Pillars of Old Age Income Security

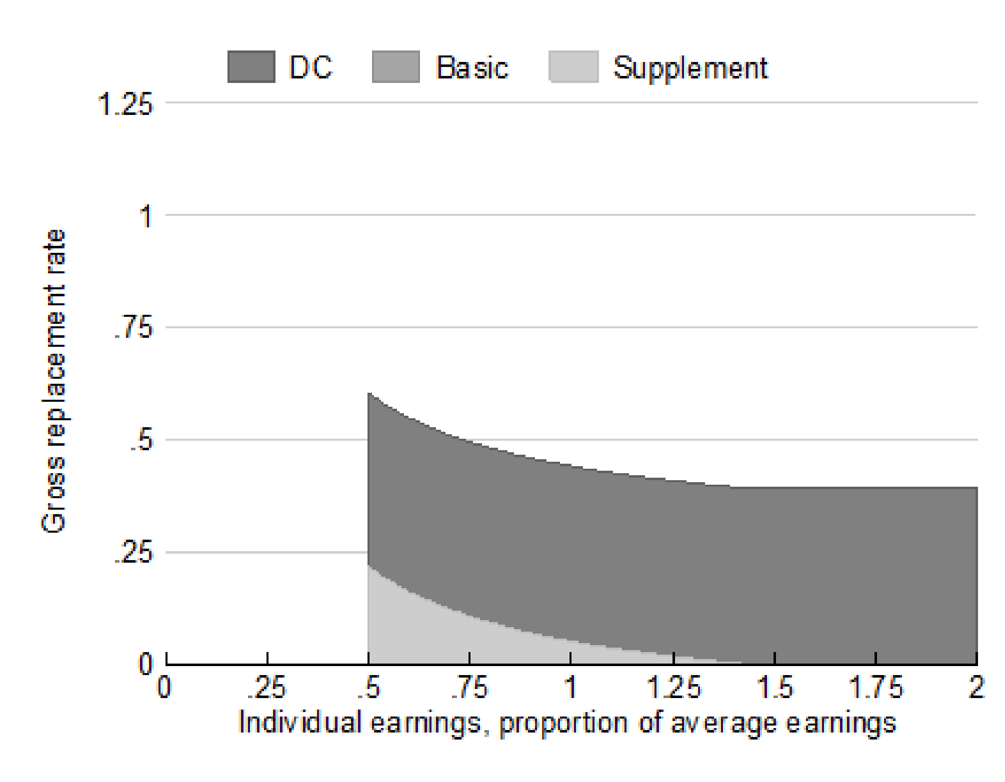


Target replacement rates and the role of the DC scheme

Sweden

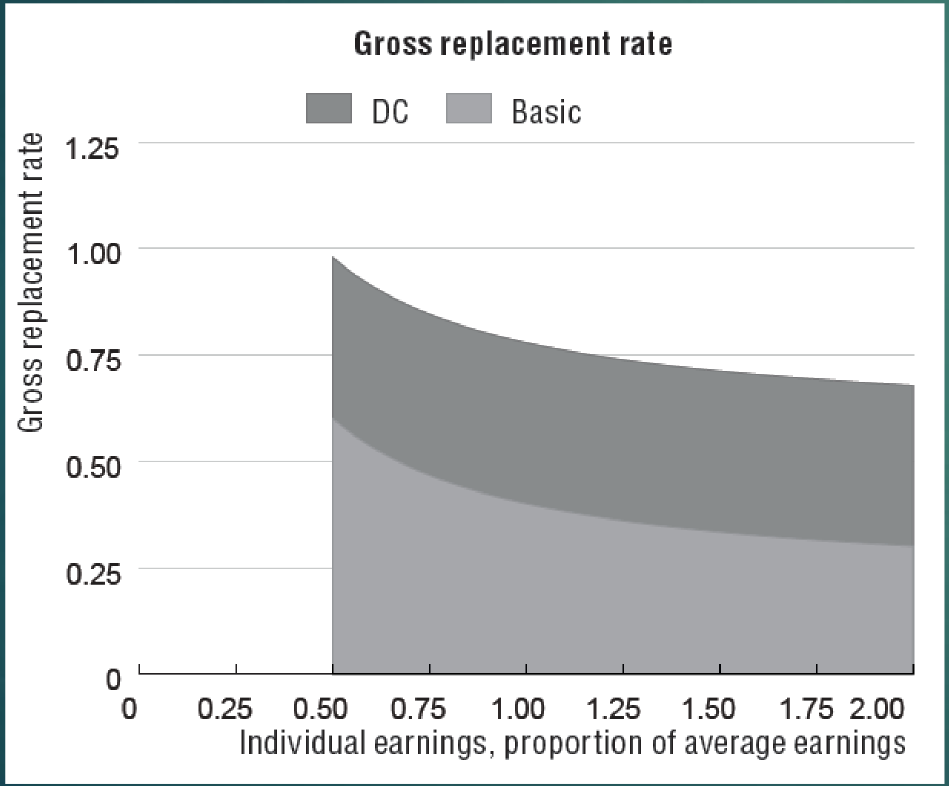


Chile

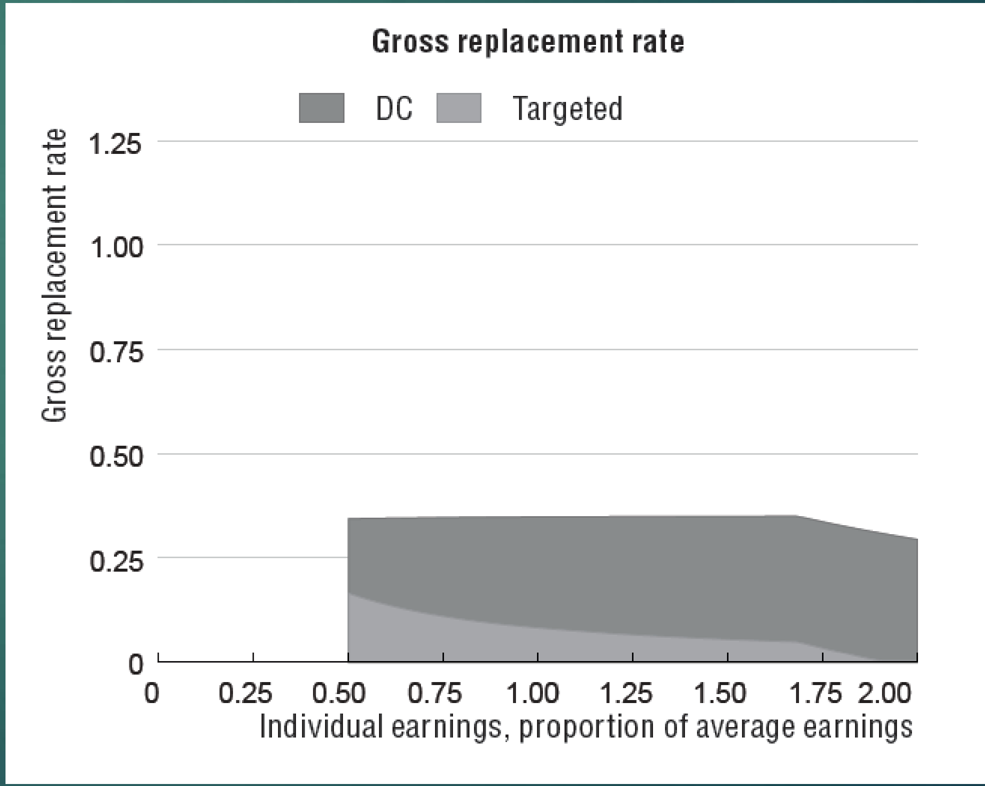


Target replacement rates and the relative role of the DC scheme

China

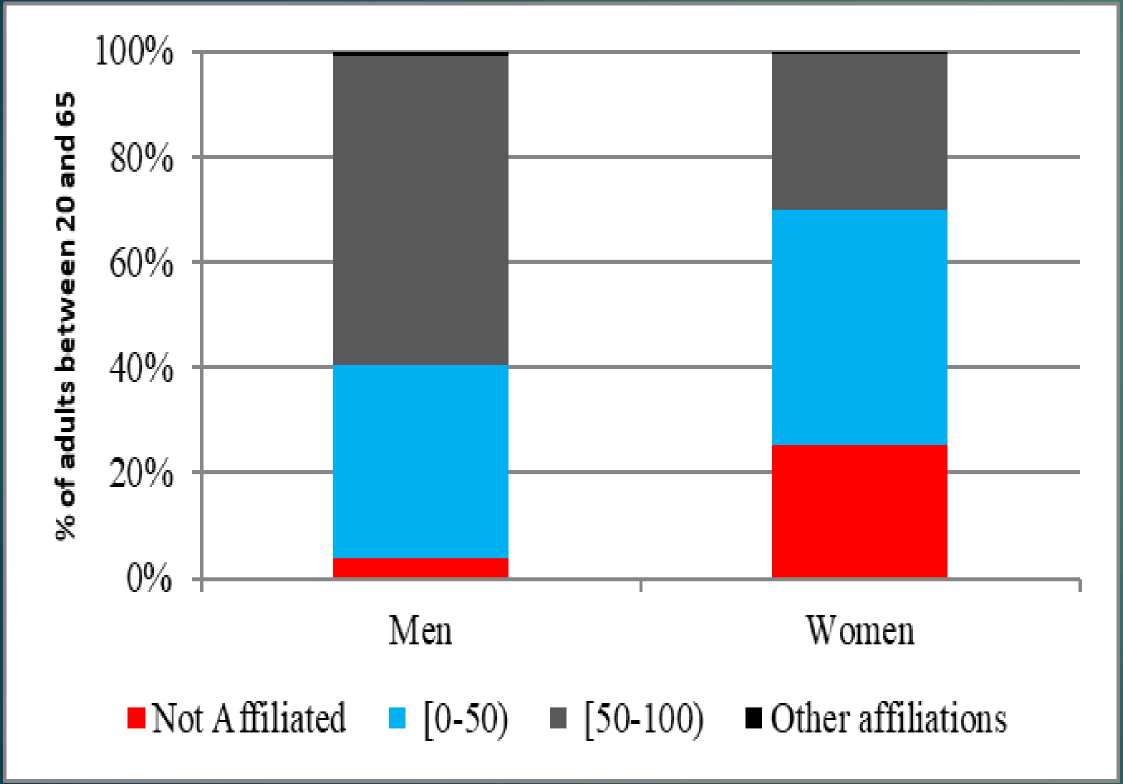


Hong Kong

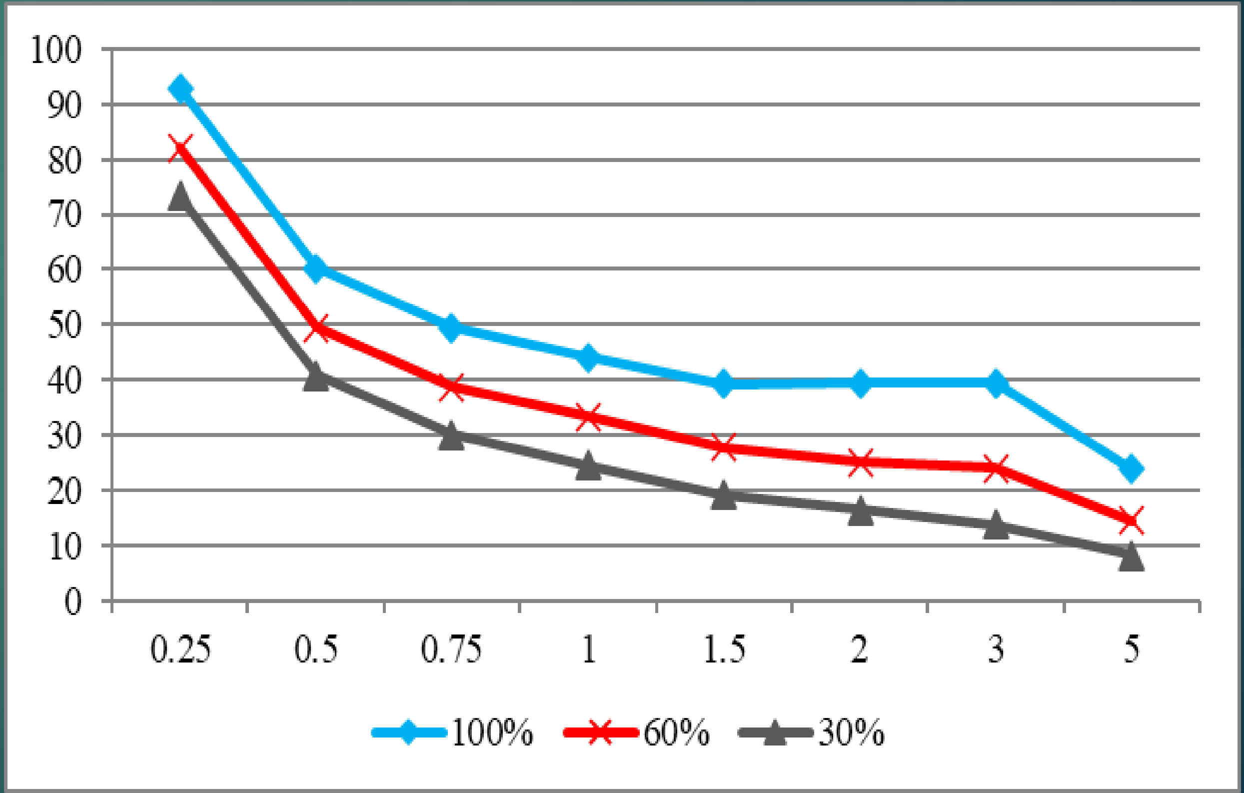


But many workers are not covered or don't contribute every year

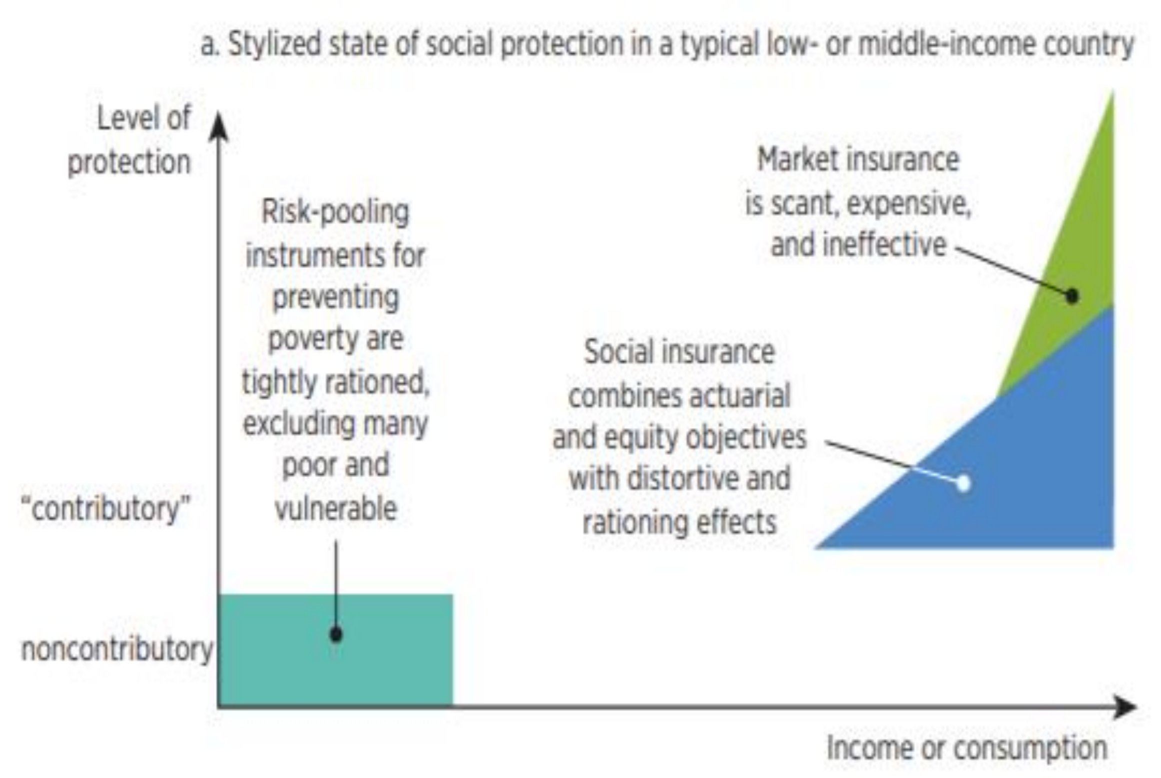
Low contribution densities

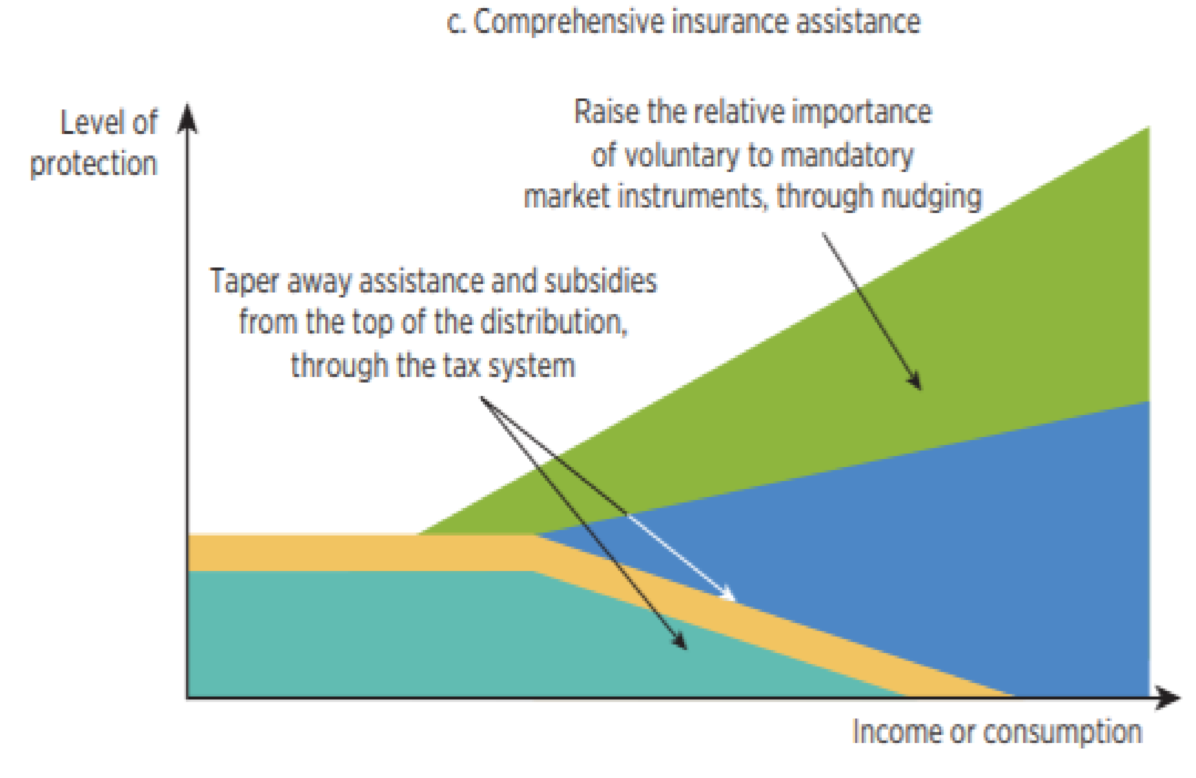


Lead to lower replacement rates



Most countries have a large informal sector





Part III
The NPF in Thailand’s pension system

National Pension Fund (NPF) Bill ร่าง พรบ. กองทุนบำเหน็จบำนาญแห่งชาติ (กบช.) พ.ศ. ...

- Mandatory provident fund for all formal workers aged 15-60 years old, who are not currently a member of a "Qualified Provident Fund".
- Contribution rates from each employee and employer (capped at 60,000 baht per month)

  Year 1 - 3 : ≥ 3% of monthly salary

  Year 4 - 6 : ≥ 5% of monthly salary

  Year 7 - 9 : ≥ 7% of monthly salary

  Year 10 onwards: no more than 10% of monthly salary

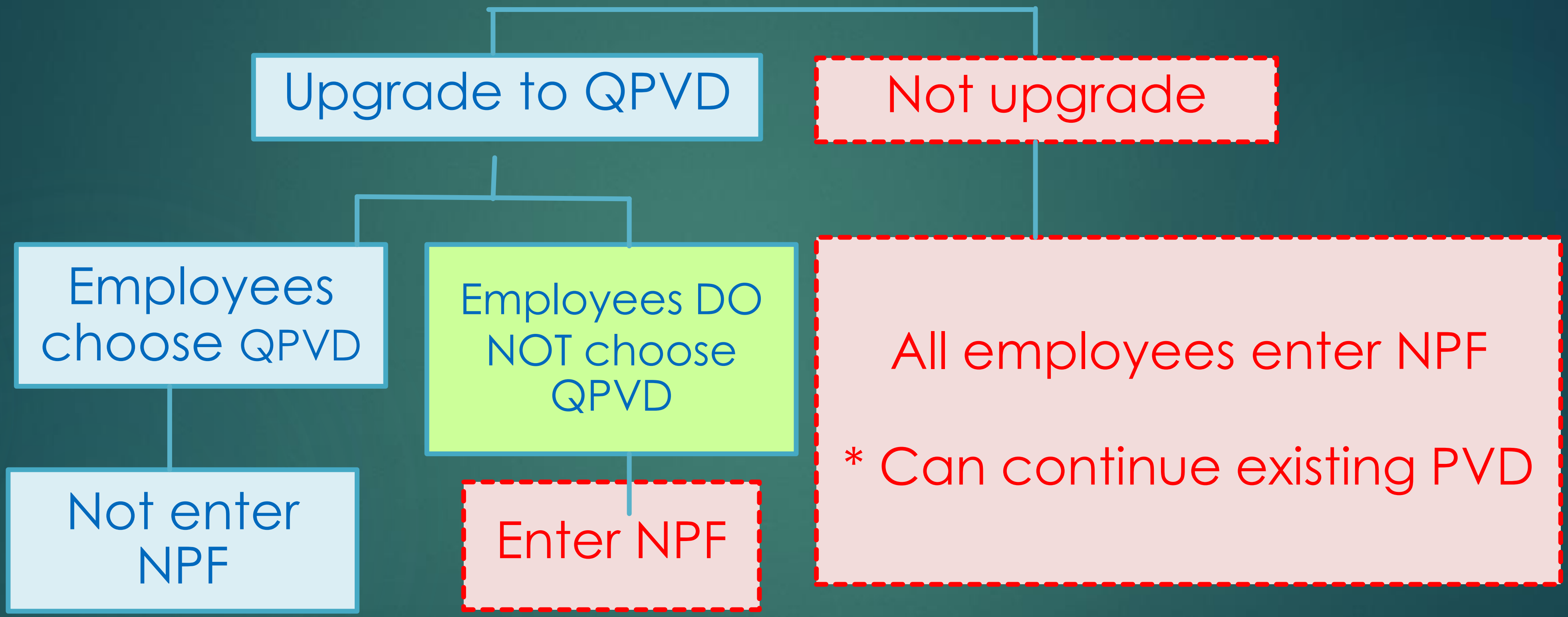
  (on top of Social Security contribution for the private sector.)
- Employees salary < 10,000 baht per month are exempted from making contribution. In which case, only employers contribute.
- Both employees and employers can choose to contribute up to 30% of the uncapped salary.

National Pension Fund (NPF) Bill : Transition

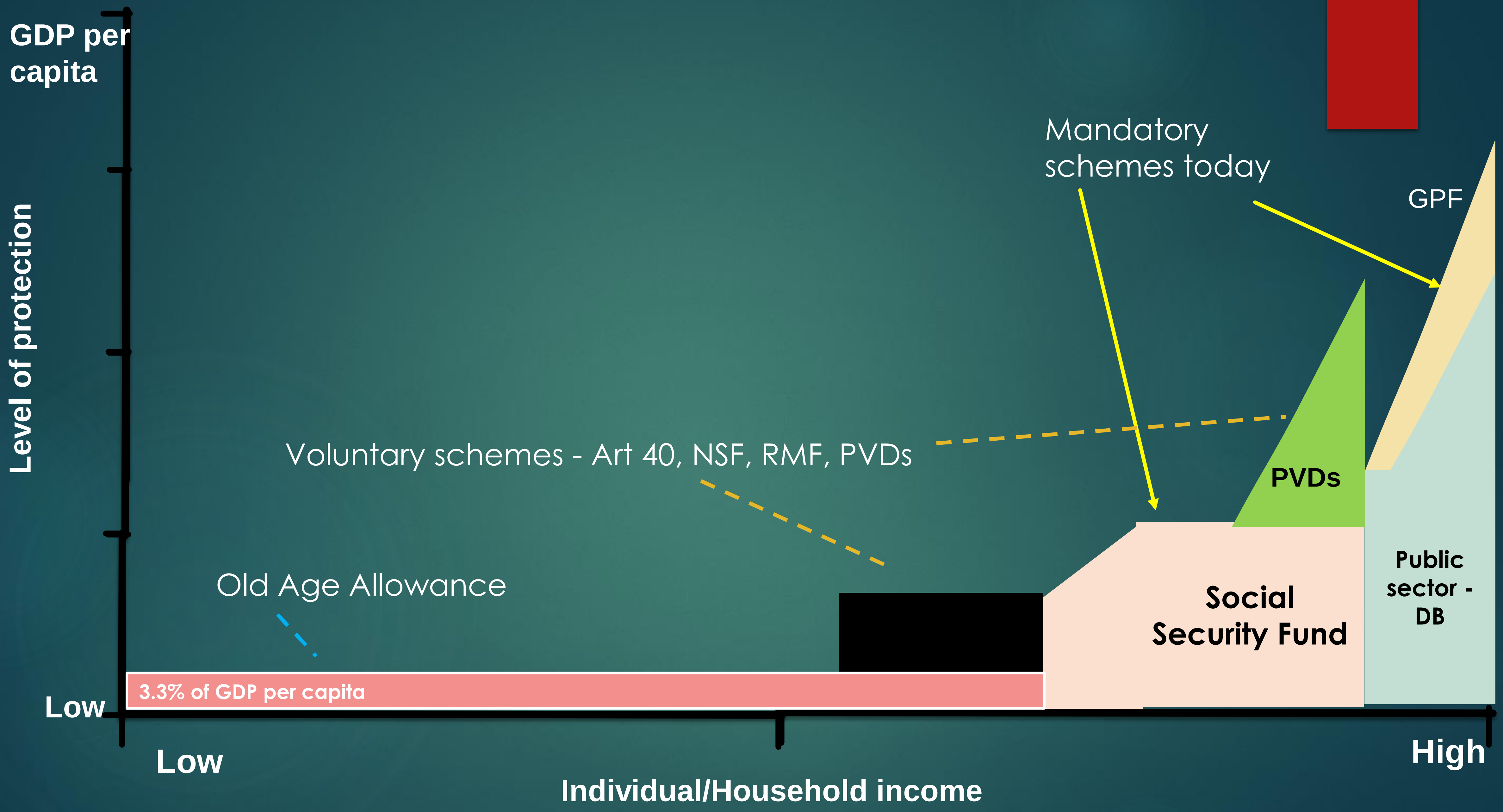
Time after the legislation being effective

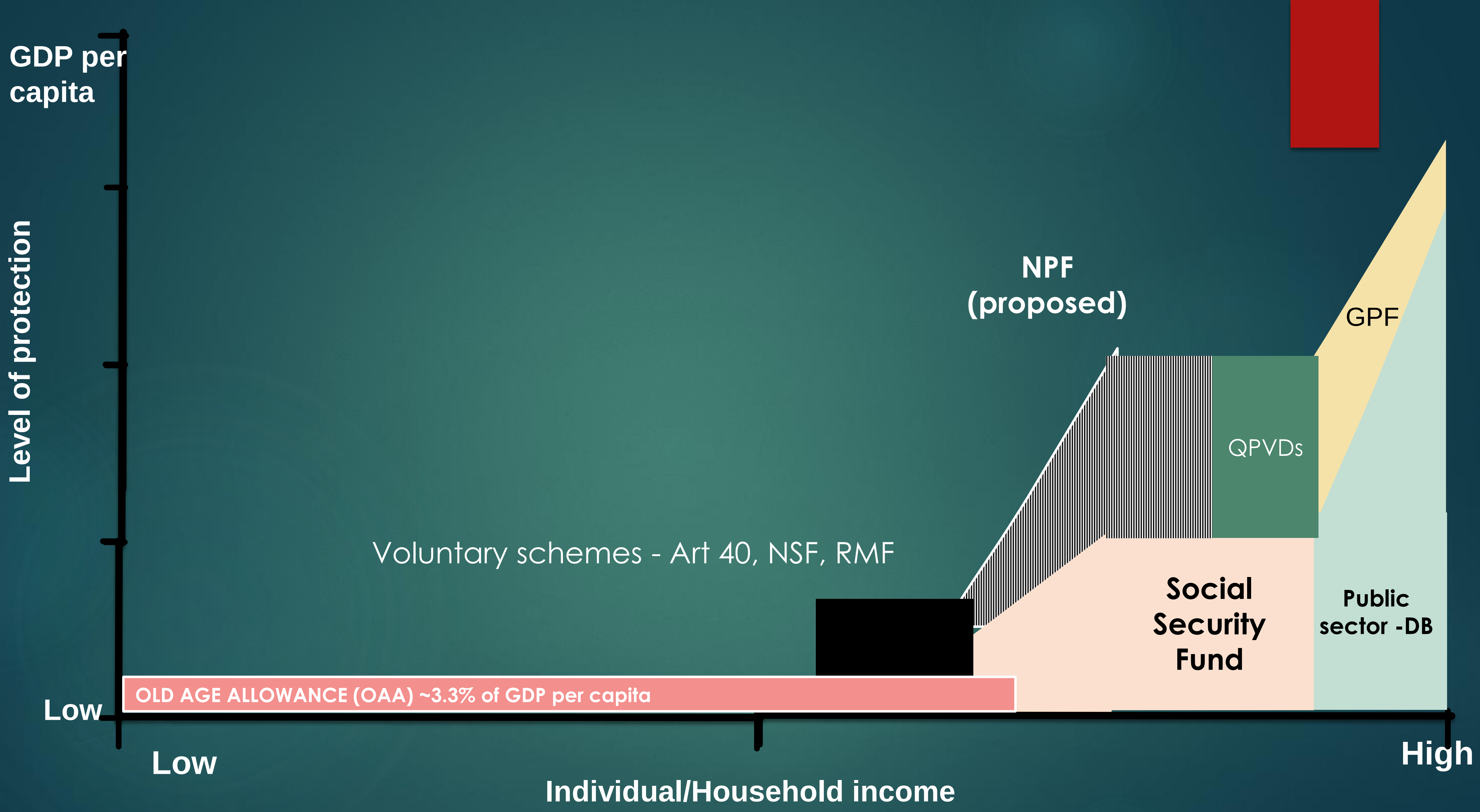
- Initially - Private companies with ≥ 100 employees
  - Concessionaire of government projects
  - Stock exchange listed companies
  - State enterprises and public organizations
  - State agencies not a member of Government Pension Fund (GPF)
  - Businesses which receive investment incentives
  - Any companies willing to participate in NPF
- Year 4 - Private companies with ≥ 10 employees
- Year 5 - Private companies with ≥ 1 employees

Options for employers currently with PVD



- The bill gives the right for employees to choose their QPVD or NPF
- Also possible to treat QPVD as one investment plan and split the money


GDP per capita
Level of protection
Mandatory schemes today
GPF
Voluntary schemes - Art 40, NSF, RMF, PVDs
PVDs
Old Age Allowance
Social Security Fund
Public sector - DB
3.3% of GDP per capita
Low
Low
High
Individual/Household income


GDP per capita
Level of protection
NPF (proposed)
GPF
QPVDs
Voluntary schemes - Art 40, NSF, RMF
Social Security Fund
Public sector -DB
OLD AGE ALLOWANCE (OAA) ~3.3% of GDP per capita
Low
Low
High
Individual/Household income

Context of NPF introduction

- Highly fragmented pension system resulting in higher administrative and transaction costs (portability issues)
- Persistent informality with a large and growing gap in pensions between formal and informal sector workers
- Maturing SSF scheme that requires reform to produce reasonable replacement rates and to avoid deficits (including higher contributions and higher retirement age)
- Added contribution for NPF would put labor taxes at 20+% and rising, further discouraging formalization and encouraging evasion
- Population aging will outpace accumulations of the new NPF

Reforms to existing system

- Index SSF earnings ceiling to wage growth
- Move to lifetime average earnings for calculation of pension
- Price index pensions
- Increase OAA and apply pension test to taper benefits
- **Gradually increase and converge retirement age** for all schemes with actuarially fair decrements/increments for early/late retirement

Structural reform alternatives

- Raise and index OAA and taper by applying pension test (Note plans for a 'digital welfare platform')
- Replace proposed NPF mandate with automatic enrollment (UK Nest approach)
- Set lower minimum contribution rate to achieve reasonable total RR
- Consolidate voluntary schemes under same administration (India NPS approach; GPF-lite?)
- Replace government 2.75% contribution to SSF and Article 40 match with same flat contribution match (delinked from wage) for formal and informal sector workers
- Consider fully subsidizing contributions of adults in poor households with the objective of reducing reliance on OAA in the long run

Conclusions

- The NPF Memorandum of Principle cites inadequate SSF pensions and low participation in voluntary plans as the problem NSF would solve
- A laudable goal but the scheme will only have a significant impact on pension adequacy around 2050 and only for a small subset of Thai workers
- Parametric reforms to the SSF would improve adequacy sooner and affect more workers
- The additional NPF mandated contribution may lead small firms move to or stay in the informal sector while properly targeted contribution subsidies have been shown to encourage formalization
- Adding a new pension institution adds to the already fragmented system resulting in higher administrative costs and transaction costs for workers (and is a major undertaking from a technical perspective)
- A holistic approach that includes parametric reforms, consolidation of existing voluntary schemes, an automatic enrolment approach and more effective use of fiscal incentives can help address both adequacy and coverage

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