

# **The Future of Thai Fund Management Industry**

Speech by Mr. Thirachai Phuvanat naranubala,  
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Chairman Chavalit, Representative of Lipper Asia and Post Publishing, Ladies and Gentlemen

1. I am pleased to attend the second year's Post/Lipper Thailand Fund Award. This is my first opportunity to attend such an event. I cannot help but feel that young as this event is, its impact on fund management industry and securities analysis will grow and grow. We are witnessing the start of something big.

2. I shall talk briefly about the past development of fund management industry in Thailand, the difficulties that we had. Then I shall finish by touching on trends of the future and the challenges that we face.

## **Past development in Thailand**

3. Fund management industry in Thailand stated as far back as the late 70s. The first type was mutual fund launched by a semi-government financial institution. It invested in stocks and took advantage of the rapid development of the Thai stock market in its early days. The opening up of the mutual fund business was done in 1992. New mutual fund licenses were granted to wholly owned subsidiaries of banks and financial institutions. Successive rounds of liberalization followed and there are now 15 mutual funds companies in operation managing a total of 470 billion baht (US\$ 12 billion) of retail savings.

4. The second type to follow mutual fund was pension fund, or what we call provident fund. The first ones were launched in the 1987. Prior to that Thailand was familiar only with the system of defined benefits in the public sector which took the form of monthly pension, on its own or mixed with lumps sum payments. At that time, the biggest burden was obviously bourn by the government - both directly for its civil servants, and indirectly through state enterprises. None of these liabilities appeared in the balance sheets. The systems were therefore carrying a big risk. The government had no choice but to gradually move from the pension system to that of managed pools of fund without defined benefits. As a consequence, the Government Pension Fund was set up by statute in 1997 to manage defined contributions plan for government employees. Assets under management now total 210 billion baht (US\$ 5 billion). Moreover, state enterprises were encouraged to set up their own provident funds and they are now the biggest component of that market which now amounts to 280 billion baht (US\$ 7 billion).

5. The Thai government moved systematically to encourage both the public and the private sector to migrate towards the provident fund system. The main incentives given were tax waivers, both on income earned by the funds --and the money to be received by

individuals on retirement. Mutual funds were also exempted for tax to promote private savings.

6. Despite its existence since the 1970's, widespread investment by funds in bonds is actually a recent phenomenon. Prior to the Asian Crisis in 1997, the Thai government ran successive years of budget cash surpluses. The idea of fiscal discipline in those days was to aim for a balanced budget. The balance budgets however invariably resulted in small cash surpluses because disbursements tended to lag behind targets. As the result, the government issued too few bonds.

7. Another obstacle to bond market development was the trend of privatization. The government was leaving the giant infrastructure projects to the private sector. The government therefore borrowed less. They had no big funding needs. They not only issued fewer bonds, but on more than one occasion, they actually redeemed some bonds before maturity.

8. What the Thai government did not realize at that time was that you need regular issues of government bonds. If you want the bond market to develop. The government has to commit itself to regular issues, a certain amount every month. There must be a pre-set issue calendar. The issues must be done by way of auction to reflect the true market interest rates. There must be issues that cover the key milestone maturities, 1-3-5-7 years, etc, in order to build up a risk free yield curve. The benchmark issues must have sufficient liquidity to reflect the real market conditions.

9. Without a deep, liquid and well functioning bond market, Thailand therefore went into the Asian Crises without a liquidity management tool. There was very little scope for circulating liquidity except through inter-bank market. One could not do it through selling bonds.

10. When the crisis broke out, the foreign banks stopped lending to Thai banks. The larger Thai banks also stopped lending to the smaller banks. Then it extended to the finance companies. Finally the public depositors took flight. During the crisis, the inter-bank market seized up. There was no bond market to circulate liquidity from cash-surplus banks to cash-deficit banks. The only way to keep the banking system running was for the central bank to take over the inter-bank function. The central bank therefore had to borrow from one bank to on lend to another because the banks were reluctant to lend to each other directly. The central bank ended up over-lent, and was saddled with huge losses that eventually had to be bailed out by the Thai government.

11. In their taking over the losses from the central bank, the government had to issue a vast amount of bonds. The bond market suddenly became very deep and liquid after the crisis. Market capitalization of Government bonds is approaching 1.1 trillion baht (US\$ 28 billion). As the result, yield curves were able to be formed. It enabled the market for state enterprises and corporate bonds to flourish as well. And also as the result, the total market capitalization for all types of bonds grew rapidly to 2.5 trillion baht (US\$ 63 billion). And with it, the fund management industry.

12. To give a complete picture of the asset management industry in Thailand today, there are now 1.2 trillion baht (US\$ 31 billion) of all types of funds under management.

Roughly 40% are mutual fund, 20% are provident funds, 30% are Government Pension Fund and Social Securities Fund with the remaining 5% the privately managed funds.

### **Future Prospects**

13. Fund management in Thailand has a very bright future. First, consider the demographic. Ten year ago, roughly half of the Thai population was under the age of 25. Today, that age level is 30. You can see that Thai demographic is moving forward the way of Europe and Japan. Although we are still relatively young, the aging process will create a big, growing demand for fund management. The potential growth in long-term contractual savings, in the form of provident funds and retirement mutual funds, is a reflection of that aging population.

14. Increasing sophistication on the part of investors will also be another positive factor. In the past bank deposits have been the main investment culture for Thai people. However, with the recent growth in various form of financial products which offer greater return, investors are now much more aware of the choices being offered. We now see a great deal of investment advisory columns in leading newspapers and magazines that cater to consumers' needs. The business is also driven by financial intermediaries who seek ways to deal with the present excess liquidity in the system. In addition, the near-term plan by the government of Thailand to lift the general guarantee for bank deposits will also spur savers to look for suitable alternatives, particularly properly managed funds.

15. The second factor is economic growth. Despite the set back brought on by the crisis, Thailand still has a strong growth potential. We are competitive in our exports, despite the advances made by the low wage countries. We do not suffer from excessive labor protection. Our entrepreneurs can adapt and change without restrictions. The rapid growth of the economy will generate savings each year that will be working for fund managers.

16. Third is the Asian linkage. Asian people will invest move and more cross border into each other's markets. It will be some time before they can do so directly, choosing their own stocks and bonds ditrectly. In the mean time, they will need the service of capable fund managers. There will certainly be a lot of business to go round.

17. The potential for fund management business in Thailand and across Asia is therefore very promising. But it is not automatic. What needs to be done?

### **The challenges ahead**

18. Probably the highest need on the agenda is a good product. For equity, it means new companies to be listed. In this respect, Thailand is very attractive. Currently we have just over 400 companies. This year alone, we shall see perhaps 130 more. Some of the new comers are also the large size state enterprises that include the Airport Authority, the Telecom Authority and the Electricity Authority.

19. However we not only need more companies but also good, well managed ones. Good corporate governance has long been an important issue in Thailand. But since the 1997 crisis it took on a new dimension. Investors and banks have realized that good

corporate governance was a key that could guide companies through difficult times. They do give premium to good governance. We have set up a national level committee headed by the Prime Minister was set up to promote it. This movement is also gaining momentum in other Asian countries.

20. Along side governance is the need for transparency. Investors require not only proper accurate accounting reports, but also auditors that they can rely on. In Thailand, 80 percents of our listed companies are audited by the firms linked to the international big four. Therefore the SEC will aim to be in close consultation with both the Association of Auditors and the audit firms to ensure that, in Thailand, transparency is strictly adhered to.

21. For bonds, developing good product means more high quality issues, large enough to ensure liquidity and with proper credit ratings and/or credit enhancement. The same need for governance and transparency applies to bonds as to stocks. This is an important issue for the long-term confidence in the fund management industry.

22. I wish to point out that late last year there was a mini run in some of the open-ended fixed income funds here in Thailand. It illustrated the need for tighter rules in this area. Currently, the SEC is pushing for new regulations that would require asset under investment to have not just sufficient quality and diversifications but also liquidity as well.

23. What is being proposed is for the open-ended funds with regular windows for redemption window of anything up to seven days, to maintain minimum ratios of liquid assets. Such rules, if agreed upon by the industry and the SEC, will take effect immediately for new funds and new money received by the existing funds. For the existing portfolios, the funds will be given sufficient time to migrate.

24. I must say, though, that rules and regulations alone will not suffice. Fund managers must also be given necessary tools to better manage their risks. Regulations enabling the funds to undertake repo transactions and to undertake securities borrowing and lending are being put into place. Thailand is also in the process of setting up a futures exchange. We aim for trading to start by the end of this year, or early next year at the latest. The products will cover both equity and debt.

25. For cross border flows, domestic funds have already been given opportunity to make investment abroad in the form of Foreign Investment Funds (FIF) and also through special approval by the Bank of Thailand. This would help to raise the profile of asset management in the country and enable the domestic funds to better diversify their investments. In this respect, further liberalization with regard to gradual flow of overseas portfolio management might be possible as has been indicated by the Central Bank. In order to do that, Asian countries will also have to consider what to do with the non-resident restrictions that are still present in some countries. In the future, they may have to consider ways to lift these restrictions in an orderly fashion too to allow foreign investors to manage their exchange risks effectively.

26. Finally, we need measurement and comparisons. For a fund manager, what is the use of your excellent performance if nobody knows it. Fund managers should be paid for

performance. In order to do that, we need organizations that can make objective comparisons and make it public. The event tonight is indeed a very good start.

**Concluding Remarks.**

27. I shall conclude by repeating the fact that fund management has a very bright future in Thailand. For the emerging markets of Asia, fund management is only in their early stages. The high rates of savings will continue. Asian wealth will accumulate. They will need professional, capable management.

28. However, challenges remain. Particularly in enforcing corporate governance, ensuring transparency and proper accounting and auditing standards. Fund management professionals can make a substantial contribution here. Authorities are often accused of failing to understand market needs. Too heavy regulations and excessively tight tax rules can hold up market development forever. Only with the right advice for market participants, especially the professional fund managers, can the right path be taken. Only with the liberal exchange of views and experiences cross borders, as is going on in this room, can we ensure that Asian capital markets truly play their roles -- the role of converting savings into productive investment. My last words to you therefore - keep up the good work.