2021 Thailand Valuation Trends

Analysis and implication of Thailand retirement scheme

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Developments in Thailand

Bond yields

- Being the eccentric year, the pandemic is unarguably the main driver for every market indicators. First response to the announcement of the pandemic together with policy interest rate reduction pushed the yields to its lowest. Concerns in money market and capital market was raised hence creating liquidity stress and irregularities in money market functions. The Bank of Thailand then intervened through government bond purchasing program amounting to more than THB 100 billion. Consequently, the yields surged up to its peak in the end of March 2020. However, continual concerns brought the yields back to the its former level.

- In April 2020, loans amounting to THB 1.9 billion was approved to alleviate the issues related to Covid-19. The measures include government bond issuance and bond switching. Together with improving situation of 2-month-no-domestic infection slightly increased the yields until August. However, the plummet in December was owing mainly to new infection wave in Thailand and also in many other countries in the world.

- Although Thai policy rate and Federal fund rate had been reduced to record low, there are also other factors namely high appreciation in Thai Baht against other main currency like US Dollar together with high volume of government injected money. These factors controlled the yields in the second half of 2020 to fluctuate in the constant level.

- In 2021, the global economy is projected to improved marginally as vaccination process has started in many parts of the world. Whereas Thai vaccination process still yet to meet this year’s target, the Thai economy is still projected to be improved along with global levels. Although policy rate remained at low levels and cases of Covid-19 in Thailand started to build up in the first quarter of 2021, the positive upturn can be observed in government bond yield after the alleviation in market concerns.

Social Security Fund and COVID-19

- The monthly contribution rate of Social Security Contribution (SSO) was reduced for employers and employees in 5 periods as shown in the table below.

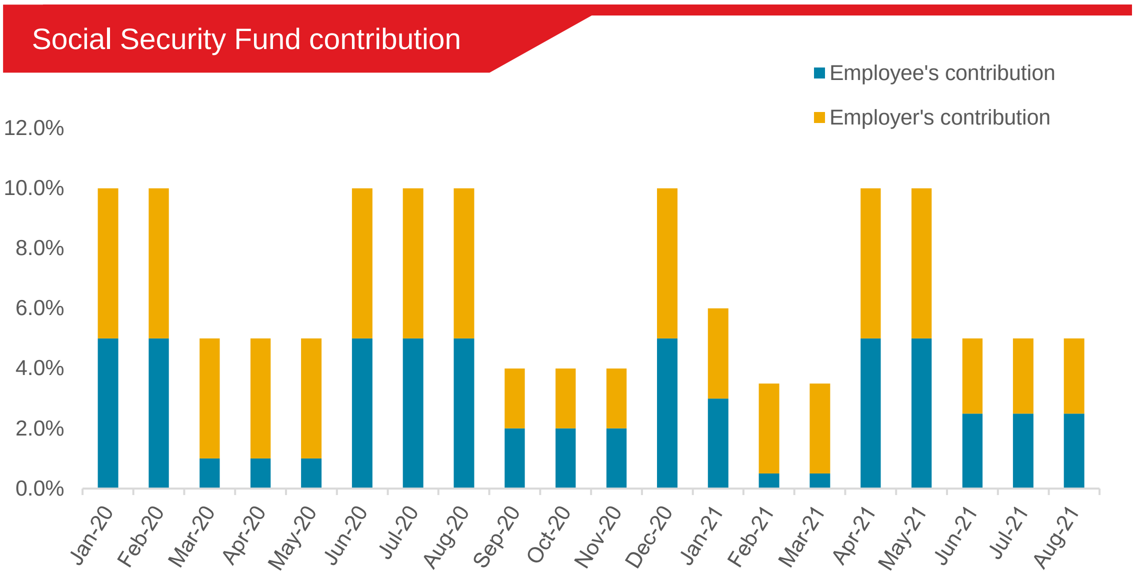

Figure 1: *Illustrates monthly contribution rate to social security fund following government relief measures*

	Normal Contribution	Mar-20 to May-20	Sep-20 to Nov-20	Jan-21	Feb-21 to Mar-21	Jun-21 to Aug-21
Employee's	5.0%	1.0%	2.0%	3.0%	0.5%	2.5%
Employer's	5.0%	4.0%	2.0%	3.0%	3.0%	2.5%
Voluntary insurer's	THB 432	THB 86	THB 96	THB 278	THB 38	THB 216

- For the year 2020, the deadline for contribution remittance by employers has been extended for 3 months after the normal deadline. Contributions that are under this extension are those with deadlines from March to May 2020.
- Effective March 1, 2020, employees are entitled to unemployment benefit of 62% of daily salary up to 90 days *(subject to salary cap)* from Social Security under the following circumstances:
  - 14 days quarantine from having contracted COVID-19.
  - Temporary discontinuation of business as a preventive measure upon government order.
  - This regulation is effective until August 31, 2020.
- Effective March 1, 2020, employees are entitled to additional unemployment benefit under Social Security for the following causes:
  - Resignation or end of contract, employees are entitled to 45% of daily salary, up to 90 days for each period of unemployment.
  - Termination by employer, employees are entitled to 70% of daily salary, up to 200 days for each termination.
  - This regulation is effective until February 28, 2022.

- As a result of the above government relief policy, accumulated contribution received was significantly reduced from THB 303,359 million in 2019 to THB 231,348 million in 2020 or -23.7%. However, the reduction in contributions is not the only main driver of slower growth of the Social Security Fund, economic downturn also affected returns of investment.
- Furthermore, the additional unemployment benefit paid out is one of the major factors to a spike in expenses. While the rest of the expenses are maintained at the same level, unemployment expense rose from THB 7,774 million in 2019 to THB 39,470 million in 2020 or 407.7%.
- The balance of the fund exhibits that the fund will be sufficient for short term. However, with the continuation of the pandemic and the increasing numbers in old-age population in Thailand, it will be a crucial challenge for the future of the fund.

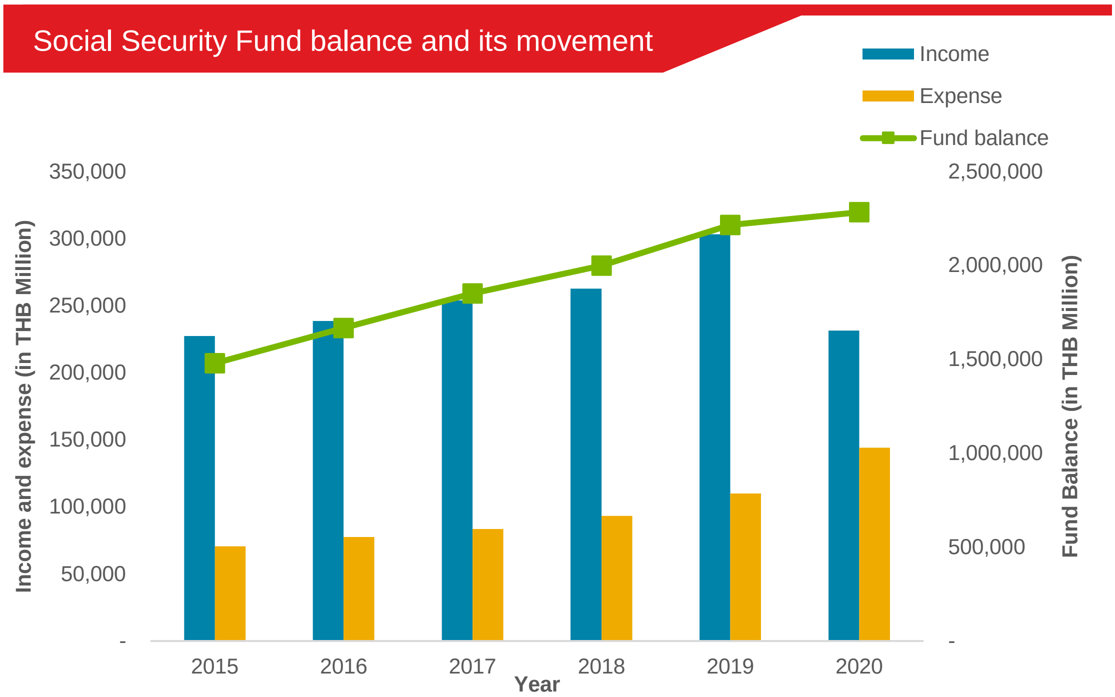

Figure 1: *Illustrates income, expense, and fund balance of Social Security Fund*

Provident fund and COVID-19

- Effective April 29, 2020, employers or employees who have been impacted financially from the pandemic can temporarily halt or postpone contributions to their provident fund until June 2021. In cases where the employer chooses to halt or postpone the contribution but employees desire the continuation of contributions, employers have a choice either to continue or halt/postpone their part of contributions.
- Although the amount of total provident fund improved every year portrays a positive sign of retirement savings in Thailand, in recent years, the number of new employers registering to participate in the provident fund decreased from 1,060 employers in 2019 to 513 employers in 2020 or a decline of 51.6%.
- While the total number of new employers are showing an increase, the number of additional employees is showing a decline. From an additional 32,773 new members in 2019, there is a 159,558 decrease in number of new employees in 2020. This may be a result of more employees dropping out from provident fund due to the increase in unemployment ie. layoffs and redundancies that occurred throughout 2020. Another possibility is where employees are opting out of the provident fund voluntarily due to higher financial stresses.

NAV VS. number of new employers in provident fund

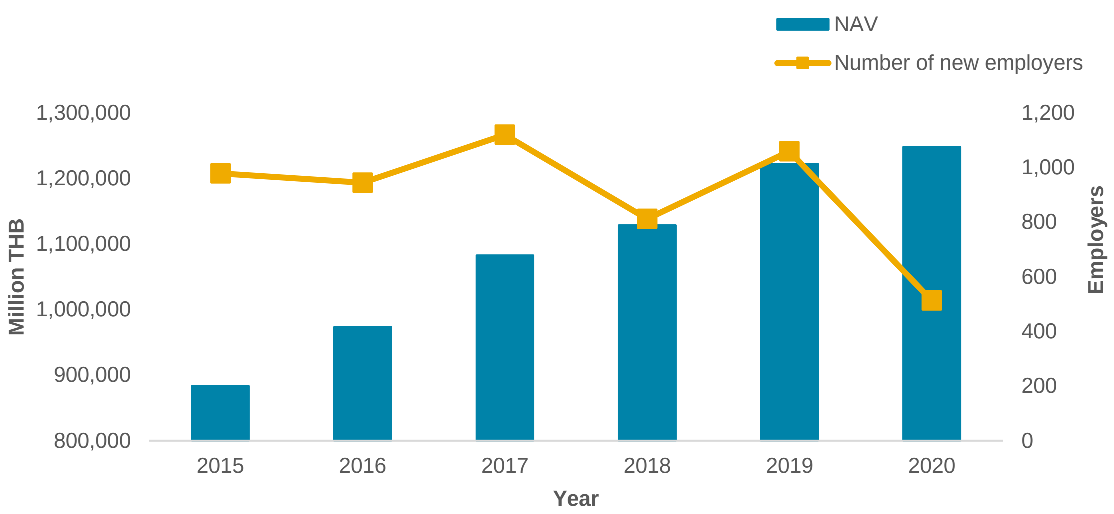

***Figure 1:** Compares a net asset value of provident fund in Thailand against number of new employers*

Number of new employees in provident fund

***Figure 1:** Illustrates number of new employees joining provident fund in Thailand each year.*

National Pension Fund (NPF)

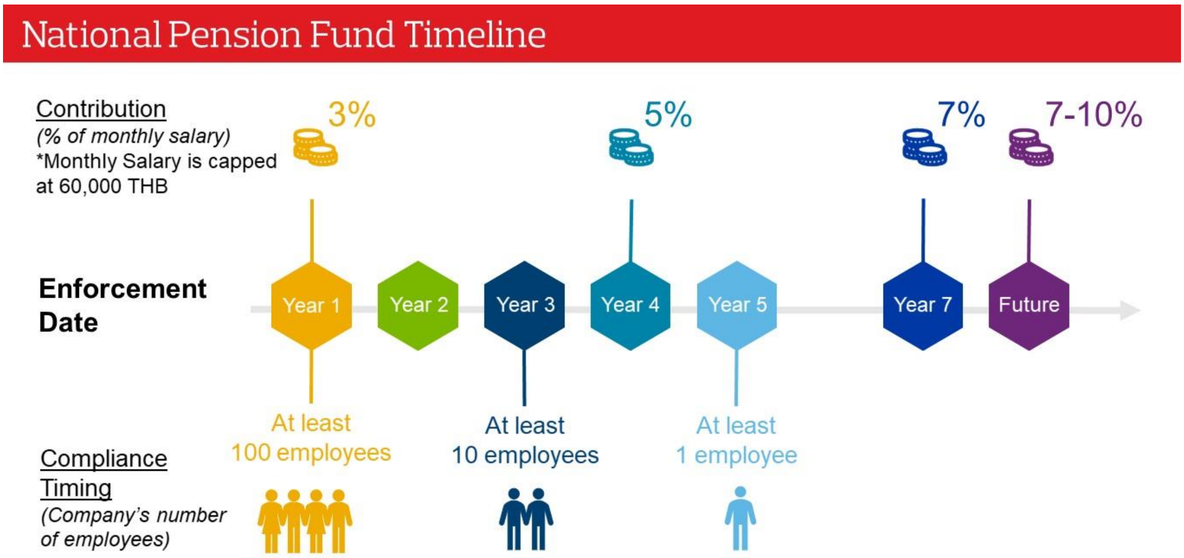

***Figure 1:** Illustrates compliance timing and contribution timeline for National Pension Fund.*

- On March 30, 2021, the Cabinet has approved in principle the idea of setting up the National Pension Fund (NPF). As people are living longer and healthier, this policy is aiming to reduce the effect of aging population by ensuring that long-term savings of elderly after retirement will be sufficient for the increasing life expectancy and increasing demand for better quality life.
- The government is hoping that the NPF scheme might help to ease government expenditure on old-age health care as well as to strengthen the retirement safety net of the people
- The NPF will require all formal employees, ages 15 to 60 years, who are not members of the existing provident fund (PVD), including employees of government agencies and state enterprises to participate.

  The time of compliance to the NPF will be based on the company's size.

Company size	Compliance
≥ 100 employees	After 360 days
≥ 10 employees	Within 3 years
≥ 1 employee	Within 5 years

- Employee and employer matching contributions starts at 3% of salaries, slowing increasing over the future years.

Year of enforcement	Minimum contribution
Year 1 – 3	Not less than 3% of salary
Year 4 – 6	Not less than 5% of salary
Year 7 – 9	Not less than 7% of salary

Note: Minimum contribution rate is not expected to exceed 10% of salary

Introduction

This report is an update to Aon Thailand's biennial *Valuation Trends* biennial study that examines the assumptions and experiences of retirement plans under the International Accounting Standard 19 (IAS 19), Financial Accounting Standards Board (FASB) Accounting Standards Codification 715 (ASC 715) *(formerly FASB Statements 87, 88, 106, 132 and 158)*, and Thai Accounting Standards (TAS 19).

The International Financial Reporting Standards (IFRS) and FASB requires companies to estimate the value of the employee benefit liabilities, while the IAS 19, TAS 19 and ASC 715 sets the rules of the determination of assumptions and reporting of these liabilities.

The main objective of this report is to provide a snapshot around the changes in financial and demographic assumptions used to value the liabilities and their actual experience during the year 2020/2021.

Discount Rate

The discount rate reflects the time value of money, and is used in measurements of benefit obligations and future expenses. The accounting standard states that discount rate should reflect the estimated timing at which the benefits would be paid.

IAS19 specifies that "*the discount rate used to discount post-employment benefit obligations shall be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. For currencies for which there is no deep market in such high quality corporate bonds, the market yields (at the end of the reporting period) on government bonds denominated in that currency shall be used*".

As Thailand corporate bond market cannot be considered 'deep', discount rates are based on yields of long-term Thai Government Bonds.

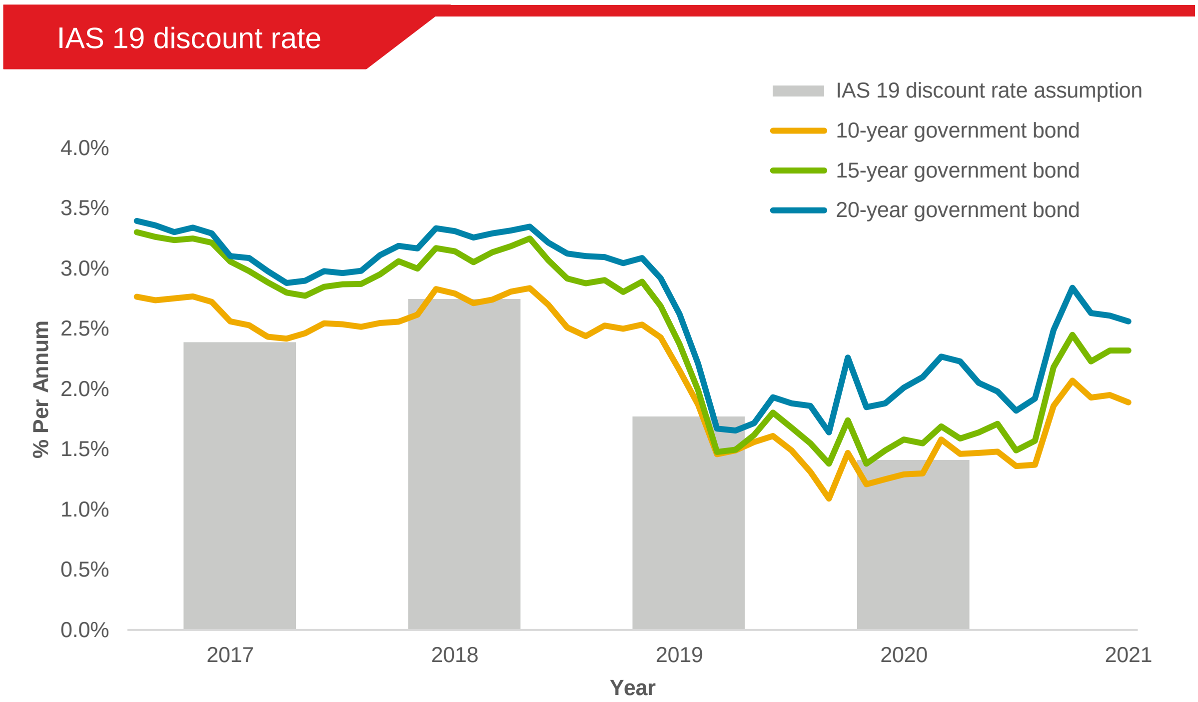

Figure 1: *Illustrates an average IAS 19 discount rate assumption adopted by the studied companies, benchmarking against government bond yields of three different maturities.*

In 2020, majority of studied companies have adopted an average discount rate of 1.6% for all maturities which is about 0.2% lower than previous year. The government bond yields reached its lowest in the first quarter at around 0.87% and 1.64% for lower and higher ended maturity respectively, increased slightly in March, then dropped to the same level. The yields gradually increased by 0.1% to 0.3% for variation of maturity the second and third quarter towards its peak in August. The yields dropped slightly again in the fourth quarter to the lowest of the year at 0.62%. Hence, assuming similar assumptions adopted, and employee demographics profile, mid-year and year-end valuation should result in roughly similar level of liabilities.

FASB ASC 715 specifies that "*discount rates shall reflect the rates at which the pension benefits could be effectively settled. It is appropriate in estimating those rates to look to available information about rates implicit in current prices of annuity contracts that could be used to effect settlement of the obligation. In making those estimates, employers may also look to rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits*".

Discount rates for FASB ASC 715 are based on yield of long-term Thai Government Bonds, plus a credit spread for high-quality fixed-income investments.

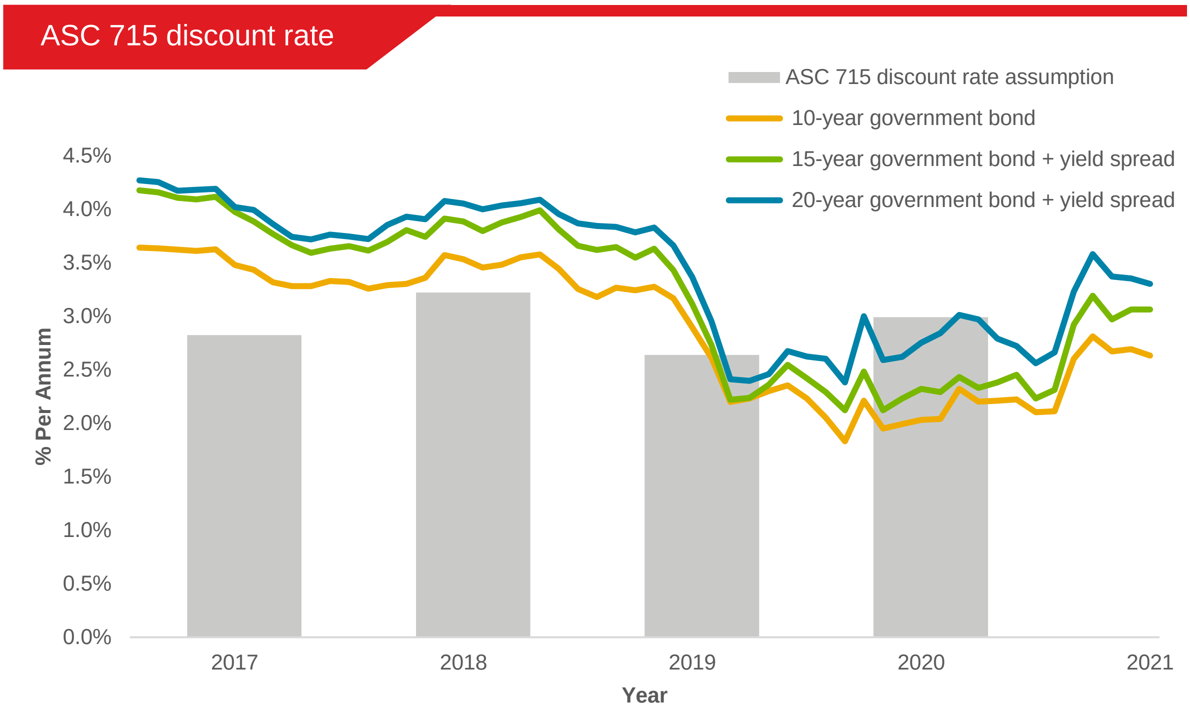

Figure 2: *Illustrates an average ASC 715 discount rate assumption adopted by the studies companies, benchmarking against the total of government bond yields of three different maturities and its corporate risk spread.*

Similar to adopted IAS19 discount rate, eight-year downward trend with a slight pickup in 2018 and 2020 of ASC715 discount rate assumption used is observed with an increase of 0.3% from 2019 to 2020.

The difference between IAS19 and ASC715 year-end discount rate, known as yield spread, increased by approximately about 0.5% from 2019. Expansion in the spread could be encouraged by the anticipation of a slowdown in economic growth in the country.

While market movements of government bond yields impact discount rates similarly, the difference in discount rate experience from year to year are dependent upon the timing of the valuation and company's employee demographic profile at valuation date.

Variations in economic activity are determined by the fluctuations in the business cycle over many months or years. Hence, business cycle is one of the key determinants of changes in bond yields. The fluctuations shown in the government bond yield could possibly be dictated by international influences or the economic upturn or downturn within Thailand.

Being the eccentric year, the pandemic is unarguably the main driver for every market indicators. First response to the announcement of the pandemic together with policy interest rate reduction pushed the yields to its lowest. Concerns in money market and capital market was raised hence creating liquidity stress and irregularities in money market functions. The Bank of Thailand then intervened through government bond purchasing program amounting to more than THB 100 billion. Consequently, the yields surged up to its peak in the end of March 2020. However, continual concerns brought the yields back to the its former level.

In April 2020, loans amounting to THB 1.9 billion was approved to alleviate the issues related to Covid-19. The measures include government bond issuance and bond switching. Together with improving situation of 2-month-no-domestic infection slightly increased the yields until August. However, the plummet in December was owing mainly to new infection wave in Thailand and also in many other countries in the world.

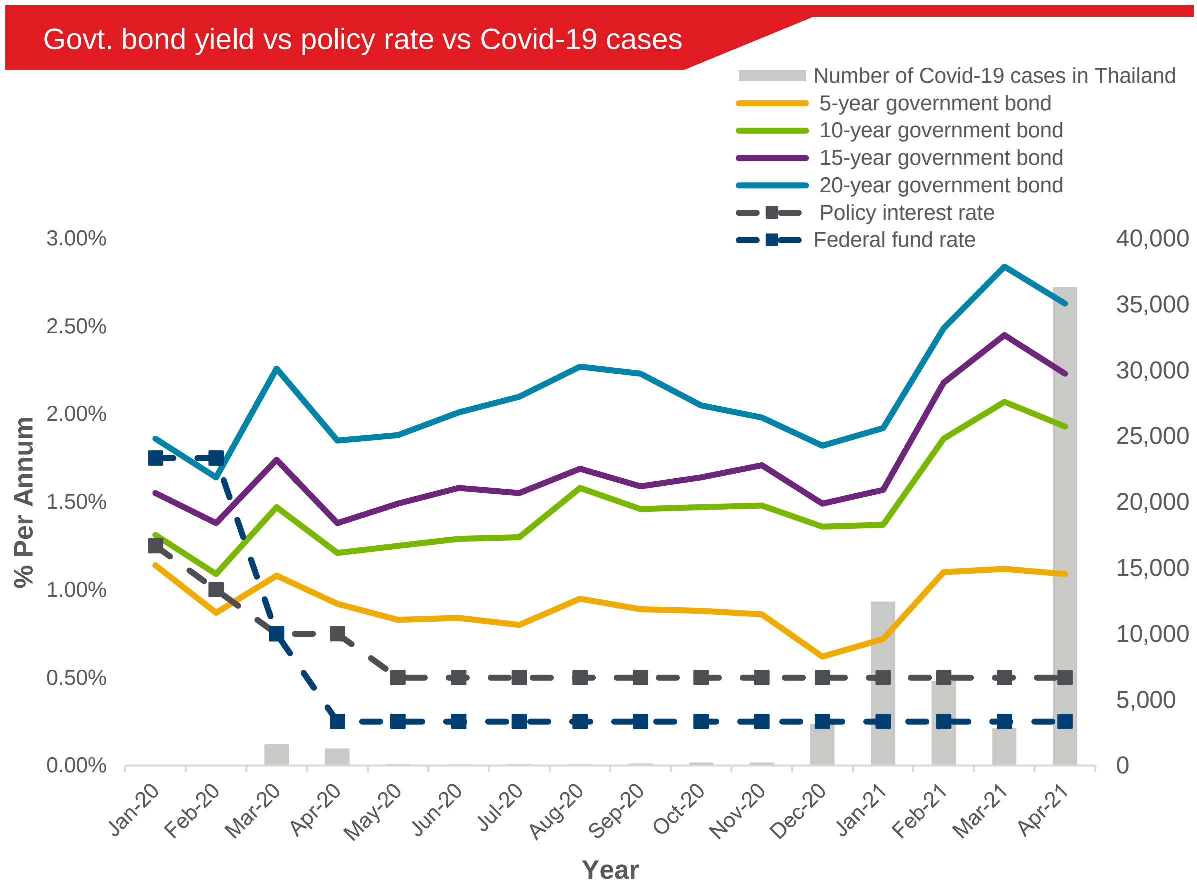

***Figure 3**: Illustrates different tenor of government bond rate comparing to policy interest rate and number of Covid-19 cases in Thailand*

Salary Increase Rate

Since most retirement benefits in Thailand are paid in form of lump-sum payment which is calculated based on employee's last salary when leaving employment, the long-term salary increase assumption is one of the crucial determinants in calculating the cost of benefits. A higher salary increase rate adopted would bring about greater expected benefit payout, which in turn led to larger liabilities.

In order to obtain accurate estimation of salary increase, the following factors might be taken into consideration:

- Annual and projected long-term inflation increases
- Level of seniority
- Merit or promotional increases
- Business strategy and productivity's improvement
- Industry trend and market benchmarking
- Other company specific factors such as: company downsizing, over-performed year, natural disaster, merger & acquisitions, changes in company strategy

Salary increase assumption vs core inflation

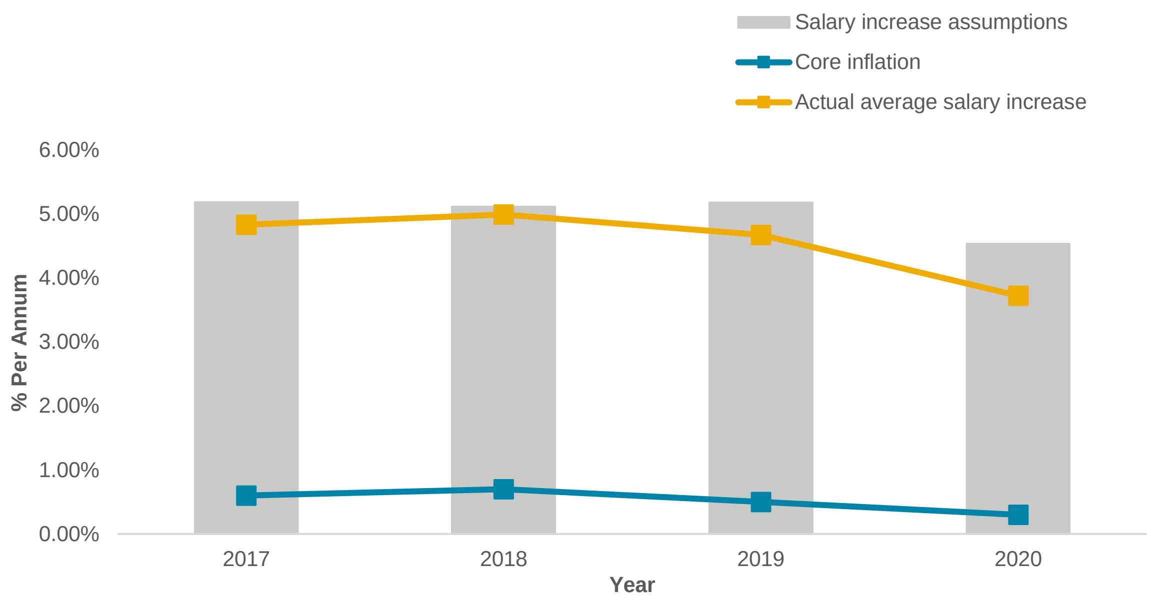

***Figure 7**: Demonstrates the movement of core inflation, average salary increase assumption and studied company's average salary increase over years.*

	2017	2018	2019	2020	2021*
Salary Assumption	5.2%	5.1%	5.2%	4.5%	n/a
Average Salary Increase	4.8%	5.0%	4.7%	3.7%	4.4%
Core Inflation	0.6%	0.7%	0.5%	0.3%	0.2%
Headline Inflation	0.7%	1.1%	0.7%	-0.9%	1.2%

* figures for 2021 are projected

The long-term salary increase assumption has dropped from 5.2% per annum in 2019 to 4.5% per annum in 2020, which is the lowest of the past nine years. The five-year average of salary increase assumption has dropped marginally from 5.2% in 2019 to 5.1% in 2020.

Compared to the end of 2019, the headline inflation has dropped as a consequence of the decrease in overall demand in tandem with economic condition, together with the extensive decrease of crude oil price in the first half of 2020. Even though with various government relief measures, demand from neighboring country, and flood driving up fresh food price in the end of the year, a plummet resulted from the first half of 2020 has dominated the direction of the inflation.

Meanwhile, the core inflation declined slightly in 2020 due to the effect of government relief measures to cut water bill in 2020. This slowdown can also be attributed to the reduced demand-pull inflationary pressures given the domestic economic stress.

Inflation for the year 2021 and 2022 is expected to be positive due to the higher demand given the recovery in economic situation together with the upside trend in crude oil price.

However, it is important that salary increase assumptions is reflective of all future salary increase in the long-term and should not be influenced by any short-term fluctuations. In the case of the current business impacts due to COVID-19, setting separate short-term and longer-term salary increase assumptions may be considered.

Actual salary increase

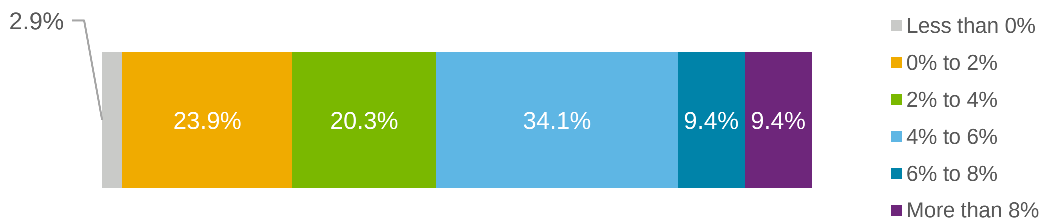

Figure 8*: Illustrates distribution of studied company's actual salary increase in 2019*

The median salary increase assumption over the year 2020 was 4.4% per annum, which is slightly higher than the average salary of 3.7% per annum. As a result of the economic downturn, the rate is observed to skew to the lower end. It is observed that there is some negative salary increases from permanent salary reductions in some companies.

Sources

- Bank of Thailand: Monetary Policy Report
- Fiscal Policy Office Thailand
- Ministry of Labour Thailand
- Office of Insurance Commission Thailand
- Royal Gazette of Thailand
- Social Security Office Thailand
- Thai Bond Market Association
- Thai Provident Fund under SEC

Contact Information

Retirement and Investment Thailand
Retirement.SEA@aon.com
+662.305.4700

Surendran Ramanathan
Actuary, Southeast Asia Practice Leader, Retirement and Investment

Xiulin Loo
Thailand and Indochina Practice Leader, Retirement and Investment

Ajjima Jenakom
Senior Consultant, Retirement and Investment

Nathawan Jirasaengchotti
Senior Consultant, Retirement and Investment

Suvimol Sthavorn
Consultant, Retirement and Investment

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