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Market Structure of the Mutual Fund Industry in Thailand

Introduction

Mutual funds are an important investment vehicle for the saving public as they provide economies of scale, diversification, and investment expertise. In developed economies, the mutual fund industry is large – typically accounting for more than 50% of GDP. In

Asia, the mutual fund industry is growing and provides diversification to global investors since its market performance does not move in tandem with developed markets. Wealth management activities are expected to grow faster in Asia Pacific than in any other region. In selected countries shown in Figure 1, the combined industry assets under management (AUM) reached about USD 11 trillion in 2015. This figure has grown at an average 18% annually for the past three years and sustained its upward trend to approximately USD 16 trillion in 2018.

The Thai mutual fund industry took off in 1992 when the Ministry of Finance ended Mutual Fund Plc.'s sole market power. While still in its early stage, compared to more developed Asian economies, the Thai mutual fund industry has grown steadily.

The ratio of Thai mutual funds' net asset value (NAV) to GDP grew at a compounded annual rate of 11.47% from 1992 to 2018 (Figure 2). The industry will likely continue to grow at a significant pace due to further liberalization of capital markets (financial and direct investment), establishment of the ASEAN Collective Investment Scheme (CIS) in 2014, and the increased demand for managed high-return investments for retirement as the Thai population ages. The Thai mutual fund industry also appears to be at an inflection point in recent years as regulators lifted restrictions to move the industry towards more regionalization. With these unique characteristics and recent regulatory developments, we describe three trends that are crucial to understanding the changing landscape and developing strate-

Figure 1: Industry Assets Under Management 2013-2018

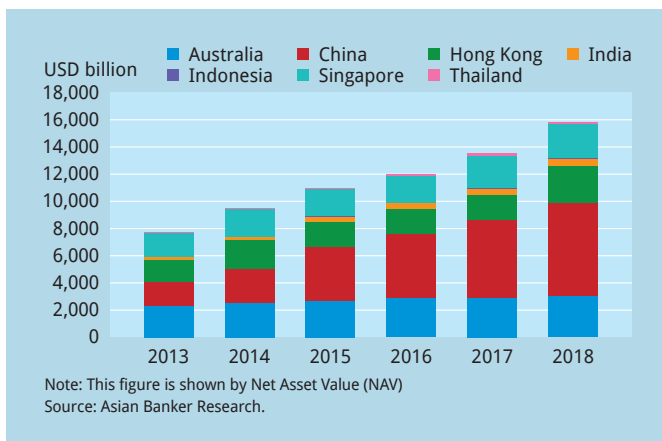
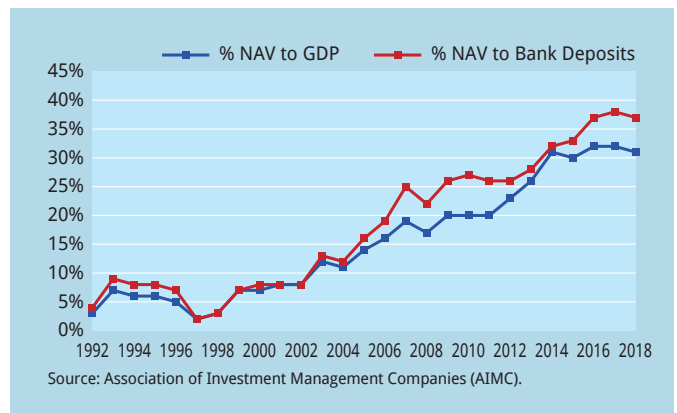


Figure 2: Percentage of Mutual Fund NAV to GDP and Bank Deposits



gic changes in the asset and wealth management industry in Thailand. They are: i) size, diversity, and market power of Thai funds, ii) perceptions of local fund managers and investors on fund investment, and iii) future opportunities, challenges, and regulatory expectations.

Size, Diversity, and Market Power of the Thai Mutual Fund Industry

The Thai mutual fund industry is dominated by fixed income funds (Figure 3). As of September 2019, the AUM of fixed income funds is THB 2,588 billion compared to the THB 1,467 billion AUM of equity funds. But equity grew at a faster rate, rising 21% between 2007 and 2019 compared to fixed income which grew 8.5%. The growth of AUM in equity funds is due not just to the increase in equity prices, which rose only 7.6% over the same period, but is mostly due to funds flow into equity funds. In more recent years, we observe a trend towards growing diversity in asset type, largely into equity and balanced funds. Despite a slower start earlier in the decade, balanced funds experienced 32% growth between 2013 and 2018 with assets rising from THB 89 billion in 2013 to THB 352 billion in 2018. Real estate investment

trusts (REITs) also increased significantly as a substitute for property funds whereas infrastructure funds emerged in 2013. Together, they account for 13% of overall Thai mutual fund assets in 2018. It is important to note that we report the Association of Investment Management Companies (AIMC) categorization of funds by underlying assets. The classification is mutually exclusive, but does not allow us to track which proportion of funds are actively managed or if they are part of special funds group. We only know that tax incentivized funds like long-term equity funds (LTFs) and retirement funds (RMFs) account for roughly 12-13% of total fund assets. Furthermore,

foreign investment funds (FIFs)*¹ have gained substantial market share in terms of assets from 13% in 2007 to 21% in 2018. The combination of growth in equity and balanced funds and increasing diversity of fund types has led to an overall decline in market share of fixed income funds, which fell from 59% of mutual fund NAV in 2007 to 49% in 2018. The industry remains resilient to adverse political and economic conditions, from international crises in 2008 and 2010 to local political conundrums including anti-government rallies circa 2010, a coup d'etat in 2014 and an election in 2019.

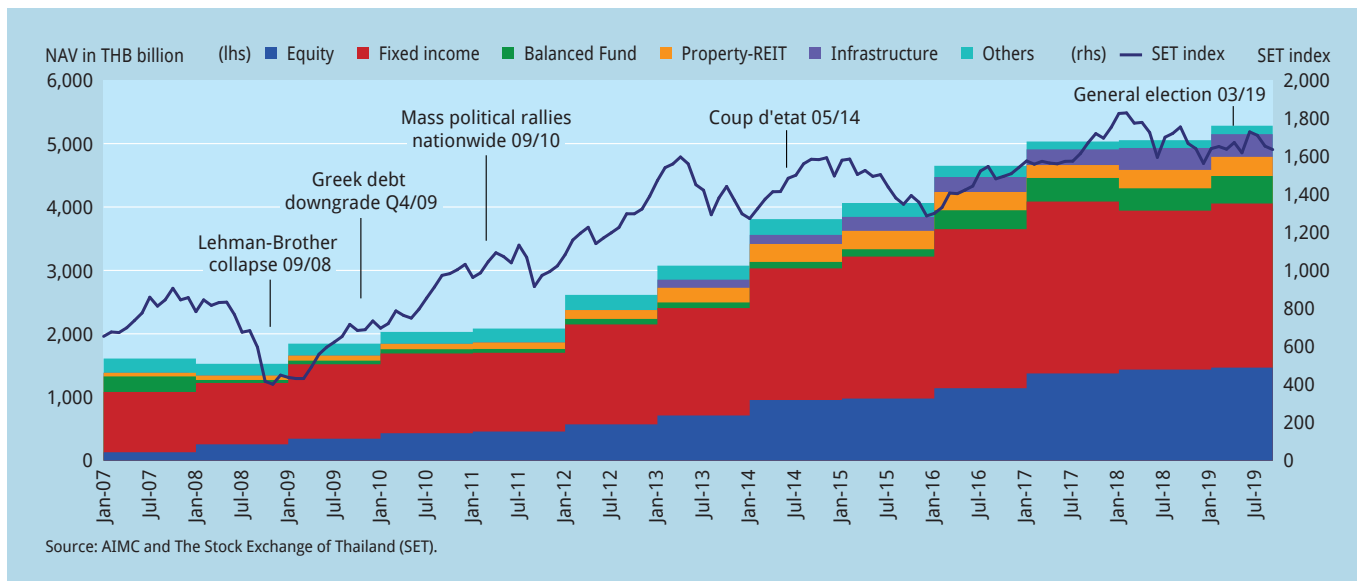
Figure 3 suggests that Thai investors

Table 1: Benchmark Optimal and Actual Portfolio Allocations from US, Global, and Thai data

	(1) US 1959-1984	(2) Global 1959-2018	(3) Thailand Agg. Mkt. 2018	(4) Thailand Optimum 2018	(5) Thailand Mutual Funds 2018	(6) Thailand MF Survey 2012
Stocks	61%	52%				
Real estate	4%	4%				
TOTAL EQUITY	65%	56%	53%	59%	36%	41%
Non-government bonds	12%	15%				
Government bonds	23%	30%				
TOTAL BONDS	35%	45%	47%	41%	64%	59%

Source: Data in columns (1), (2), and (3) are from Ibbotson et al. (1985), Doeswijk et al. (2018), and the World Bank, respectively. Column (4) is from the authors' estimates using Markowitz optimal portfolio analysis with monthly historical on Thai stock market and bond returns from January 2006 to December 2018 and a risk-free rate average of 2.83% annually. Columns (5) and (6) are data from AIMC and from Charoenrook and Pavabutr (2017).

Figure 3: Mutual Funds by Fund Type and Equity Market Performance



Source: AIMC and The Stock Exchange of Thailand (SET).

are risk averse since they invest a lot in fixed income, but that is not the case. Table 1 column 3 shows that in aggregate the distribution of Thai investments is close to global and local mean-variance optimum. However, fund data and our survey in Charoenrook and Pavabutr (2017) show that mutual fund investment is tilted towards fixed income. Hence, it is the case that Thai investors invest more in fixed income through mutual funds and invest more in equity through direct investment.

The Thai fund market is dominated by domestic asset managers. As of Q3 2019 the 1,816 funds in the market are managed by 24 different investment firms: 11 Thai bank-related, 7 foreign, and 6 non-bank Thai firms.*² Table 2 presents the detailed tapestry of the mutual fund industry. Notable is the dominance of bank-related mutual funds.*³ While these numbers seem to point to a move towards complete market dominance by local banks, we need to be aware that foreign banks have been acquiring strategic stakes in local banks to gain local brand recognition. For example, if we treat Thai Military Bank and Bank of Ayudhaya, which are strategically controlled by ING and Sumitomo Mitsui Financial Group respectively, as foreign, then the revised aggregate market share for Thai banks without sizable strategic foreign partners falls to 73%, a level close to that found at year-end 2007. “Thai banks” manage 94% of the fixed income funds which are the majority of the mutual funds.

To further analyze the within-group market power of local banks, we constructed a normalized Herfindahl Index for each year from 2007 to Q3 2019. Let N be the total number of local banks, the normalized index creates a value ranging

from $1/N$, when all firms have equal market share, to 1.0, when the market is monopolized by one firm. Table 3 reports for each year the normalized Herfindahl Index using only market share information of 11 the local banks. We find that the index on equity and fixed income funds for Thai banks is below 0.2, suggesting that no particular bank dominates these asset segments. The index results for infrastructure funds are notably larger, mainly above 0.3, but only because just four Thai banks have launched such funds thus far. The latest market share in the infrastructure segment is in favor of Siam Commercial Bank and Bangkok Bank asset management groups. To summarize these results, while we do find that local banks dominate the fund management scene, it is apparent that no particular bank dominates any of the mutual fund market segments.

Investors’ Behavior and Fund Managers’ Perceptions

In a World Bank policy paper, Fernando, Klapper, Sulla, and Vittas (2003) conducted a comprehensive study of determinants of mutual growth in forty countries around the world and concluded that growth in mutual fund sectors is determined by demand, supply, and regulation. The authors focused on the usual variables including GDP growth, the sizes of bond and equity markets, market trad-

ing liquidity, and the size of the national banking sector. We employ a different approach by drawing on fund managers’ point of view from our survey of fund managers that appears in Charoenrook and Pavabutr (2017). We argue that fund managers and management teams have perspectives on investor behavior, market constraints, and regulatory effectiveness that can affect industry direction. We collected 83 respondents (more than half of the fund managers in the industry) in our survey and conducted personal interviews with ten top management personnel from various funds, including Kasikorn Asset Management, Siam Commercial Bank Asset Management, Bualuang Asset Management, and a few non-bank funds such as the Government Pension Fund, MFC, and Asset Plus.

Why aren’t Thai mutual funds investing more in equity? Fund managers in our study view that regulation is the biggest hurdle, in particular the overall equity holding limit, which allows no more than 15% in a single equity security or not exceeding the asset weight in the benchmark index plus 5%. While the rule encourages funds to diversify, it seems to lead all equity fund performance to converge to the mean market return as no equity fund can deviate far from market weighted benchmarks. Morningstar’s *Global Investor Experience (GIE) 2017* report notes that most markets, with the exception of China, India, and Thailand, impose no limitations on what funds can invest in. The second most significant hurdle is equity market constraints due to insufficient liquidity. As of Q3, 2019, the market cap of SET and Market for Alternative Investment (mai) combined is THB 17,000 billion for all 715 firms. Size is heav-

Table 2: Mutual Fund Market Share by Asset Type and Association as of Q3 2019

	Equity	Fixed income	Balanced	Property	Infrastructure	Total*
Thai banks						
AUM THB billion	1,132	2,442	396	280	335	4,585
% Market share	77%	94%	91%	93%	94%	89%
Foreign						
AUM THB billion	113	98	21	5	0	237
% Market share	8%	4%	5%	2%	0%	5%
Non-bank Thai						
AUM THB billion	222	48	17	18	23	328
% Market share	15%	2%	4%	6%	6%	6%

Source: AIMC and authors’ computations.

Table 3: Normalized Herfindahl Index* of Bank-related Mutual Funds in Thailand by Asset Type

	H* Equity	H* Fixed Income	H* Balanced	H* Property	H* Infrastructure
2007	0.064	0.108	0.255	0.155	.
2008	0.136	0.118	0.114	0.101	.
2009	0.103	0.150	0.144	0.133	.
2010	0.094	0.177	0.115	0.114	.
2011	0.097	0.190	0.098	0.110	.
2012	0.087	0.168	0.071	0.093	.
2013	0.090	0.174	0.064	0.176	0.431
2014	0.086	0.155	0.067	0.202	0.439
2015	0.073	0.139	0.077	0.202	0.394
2016	0.078	0.130	0.093	0.209	0.390
2017	0.076	0.118	0.142	0.132	0.388
2018	0.072	0.126	0.126	0.126	0.134
Q3 2019	0.070	0.120	0.140	0.134	0.319

Note: Define the Herfindahl index (H) as $H = \sum_{i=1}^N S_i^2$, where S_i is the year-end market share of fund management firm i in the market and N is the number of firms. The normalized

Herfindahl index (H^*) is $H^* = \frac{(H - (1/N))}{(1 - (1/N))}$.

Source: AIMC and authors' computations.

ily skewed towards a much smaller subset of SET 100 firms which account for over 75% of total market value. Next, consider the average free float of approximately 40%, leading to a relatively lower effective turnover. Clearly, there are neither enough stocks nor liquidity to go around, given that the average size of equity funds is around THB 2 billion and there are, in total, around 700 equity funds chasing after too few firms with investable liquidity.

The fund managers we interviewed and surveyed also believe that investors have more interest in fixed income funds as they are perceived as a close substitute for deposits. Mutual funds, which do not carry burdens related to non-performing loans, are able to offer attractive returns on deposit-like instruments.

How important is local brand and what do investors expect from funds? This is indeed a crucial question for foreign and local non-bank asset management companies alike. We learnt from our survey that local fund managers perceive that local investors rank brand more important than historical performance and product diversity. An earlier study by Chunhachinda and Nathaphan (2012) tested the determinants of Thai mutual fund growth and concluded that fund growth is significantly related to brand and distribution channels. Our sur-

vey respondents also view that improvement in the level of financial literacy can boost interest in equity funds. This finding corroborates results of a survey of government pension fund members conducted by Budsaratragoon et al. (2011) that found questionnaire respondents were highly risk averse and exhibited an exceptionally strong home bias in their asset allocation decisions. However, it is important to note that these observations apply to investors who identify themselves as having no financial experience. In our analysis stated earlier, we find that the aggregate allocation between equity and fixed income in Thailand as a whole is close to the mean-variance optimal allocation, suggesting that investors with the financial means and knowledge prefer to invest directly in the equity market and not through equity funds.

Besides brand reputation, fund managers perceive that investors also care about internet service and easy access to branches, but exhibit much less concern about fund expense ratios. Perhaps this is because Thai fund expenses have been rather low by international standards (See Morningstar GIE, 2017 and 2019), and fund managers in our survey indicate that they are not concerned about falling short of risk-adjusted performance targets.

Future Opportunities, Challenges, and Regulatory Expectations

Regulations play an important part in the evolution of Thai mutual funds.*⁴ Thai regulators have thus far adopted the path of gradual liberalization: balancing the needs of market stability by promoting institutional investors, providing retail investor protection, and strengthening the local financial sector before they are ready for more open international competition. We have seen that tax rules have a large impact on the growth of tax incentivized funds like LTFs and RMFs, which individuals can use to reduce total annual income tax liability. The dominance of Thai commercial banks in the mutual fund sector is a consequence of initial stipulation that a mutual fund must be a Thai juristic person, must meet a sizable initial investment, and that the channels of fund marketing must be authorized by the Securities and Exchange Commission,

Thailand (SEC), giving banks a standing advantage in fund marketing due to their recognized “brands” and their nationwide network of branches.

There are two key forces driving the move towards more loosening of regulations. First is that the aging population requires faster development of mutual funds to relieve the financial pressure on national social security systems to provide full retirement benefits.^{*5} Local market impediments on trading liquidity, limited new supply of debt and equity, and holding limits on single stocks (not exceeding 15%) and sectors (not exceeding 25%) mean that growth and diversification opportunities from the local supply side may eventually fall short of demand. Second, is the establishment of the ASEAN CIS which was implemented in August 2014 and aims to establish a single market for goods, services, investment flows and skilled labor. Under the ASEAN CIS framework, fund managers in Malaysia, Singapore, and Thailand may offer collective investment schemes or funds to retail investors in the three countries under a streamlined authorization process. A related scheme is the Asia Region Funds Passport^{*6} signed in February 2019, which allows mutual recognition of funds cross-border.

With these on-going developments, there is a clear trend towards regionalization and increased asset diversity of fund availability in Thailand. Beginning next year, the tax privilege to LTFs will end and be replaced by Sustainable Equity Fund (SEF) which must place 65% combined investment in ESG-certified listed firms (list will be re-evaluated by the SET semi-annually) and infrastructure funds (IFFs).^{*7} In our view, this move suggests that regulators intend to use mutual funds to help achieve national development goals in targeted industries as well. We also expect to see a growing number of REITs, which are set up to replace existing property funds. Unlike property funds, REITs are allowed to leverage and must comply with international standards on asset appraisals.

Will the dominance of Thai commercial banks in the mutual fund sector remain unchallenged? Although the barriers to setting up foreign funds in Thailand are coming down, an important hurdle that remains is the issue that fund marketing is separated from the application to set up a fund. This means foreign funds must solicit and offer funds for sale through an SEC-licensed local partner. Already, some foreign funds or banks ob-

tain a faster track to marketing channels, local brands, and captive clientele by acquiring a controlling or non-controlling stake in an asset management company or a bank.^{*8} The former is not subject to prior authorization by the SEC. However, this tight marketing rule applies only to distribution of funds to retail investors. Foreign funds can market their products directly to institutional investors and high net worth individuals through private funds, which carry fewer investment restrictions. In the past two years, banks and their asset management arms have been slowly developing digital fund marketing platforms that offer open architecture for fund sales. Although most Thai banks currently do not sell other banks’ funds through their branches, a small but slowly growing number have become more open to selling competing funds on their digital platforms, and the practice will definitely further reduce the importance of physical branches as marketing channels.

Conclusion

In terms of international competitiveness, Morningstar’s GIE surveys in 2015 and 2017 attribute the improvement in Thai mutual funds’ overall scorecard to their relatively low fund fees and expenses, favorable taxations, in particular tax credits provided to investors in long-term funds, and transparent disclosure of fund holdings. However, Thailand’s scorecard on sales practices is the lowest among its other scorecard rankings due to the absence of an open architecture platform for fund sales and narrow distribution channels available mostly through commercial banks. Recently, though, we are witnessing digital platforms for open fund architecture that also enable asset and wealth managers to widen their reach and better understand investor behavior. This in our view, along with allowance of fund passporting, is likely promote regionalization by increasing opportunities for foreign asset management brands and for local investors to access more diverse investment choices. Though, admittedly, the path towards fully open distribution channels

will be slow, the remaining hurdles will be the speed of Thai equity market development in terms of new listings. Otherwise, growth in equity funds will rely on international equity investments. In time, improvement in financial literacy could definitely divert more savings to mutual funds from bank deposits, which are now more than twice the size of the entire mutual fund industry.

Notes

- *1 Thai asset management firms were allowed to set up FIFs since 2002, but strict regulations on licensing and a ceiling on fund size impeded their development. After 2005, the Bank of Thailand began to relax these restrictions and FIFs were included in the AIMC database from 2007 onwards. Today setting up FIFs still require approval from the SEC, and these funds must put more than 80% of AUM in foreign assets (most in the form of feeder funds).
- *2 Since August 2003, local Thai financial institutions have been allowed to apply for fund management licenses, but only through separate entities which they own 75%. Subsequently, many banks set up an asset management arm where they hold majority control. We define an asset management company as foreign if the controlling shareholder is foreign and has a foreign origin. Data available on www.aimc.or.th.
- *3 Bank related fund refers to mutual fund companies in which banks own more than 50%.
- *4 The SEC and the Capital Market Supervisory Board (CMSB), a supervisory authority within the SEC organizational structure, are responsible for regulating funds and fund managers. The Thai central bank also regulates investment of offshore funds issued by foreign entities or which originated in certain foreign markets to monitor outflows of Thai baht and foreign currencies to pay for the purchase of foreign-issued securities or investment units.
- *5 See National Statistics Office, the proportion of elderly population to total population will grow from 20% in 2021 to 32% by year 2040.
- *6 Jurisdictions include Australia, Japan, New Zealand, South Korea, and Thailand.
- *7 At the time of this writing the fund is called SEF. At print date, the fund has been renamed Super Savings Fund (SSF) with details expected to be released by the Thai

SEC within the first quarter of 2020.

*8 Singapore's United Overseas Bank (UOB) and Malaysia's CIMB made an early start by acquiring Bank Asia and Bank Thai in 2005 and 2008, respectively. In 2007, the Dutch bank, ING took a controlling stake in Thai Military Bank. More recently, in 2013, Japan's MUFG acquired 75% of Bank of Ayudhaya.

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