



13 July 2010

Malaysia's Pension System from Multi-pillar Perspective Current Status and Issues

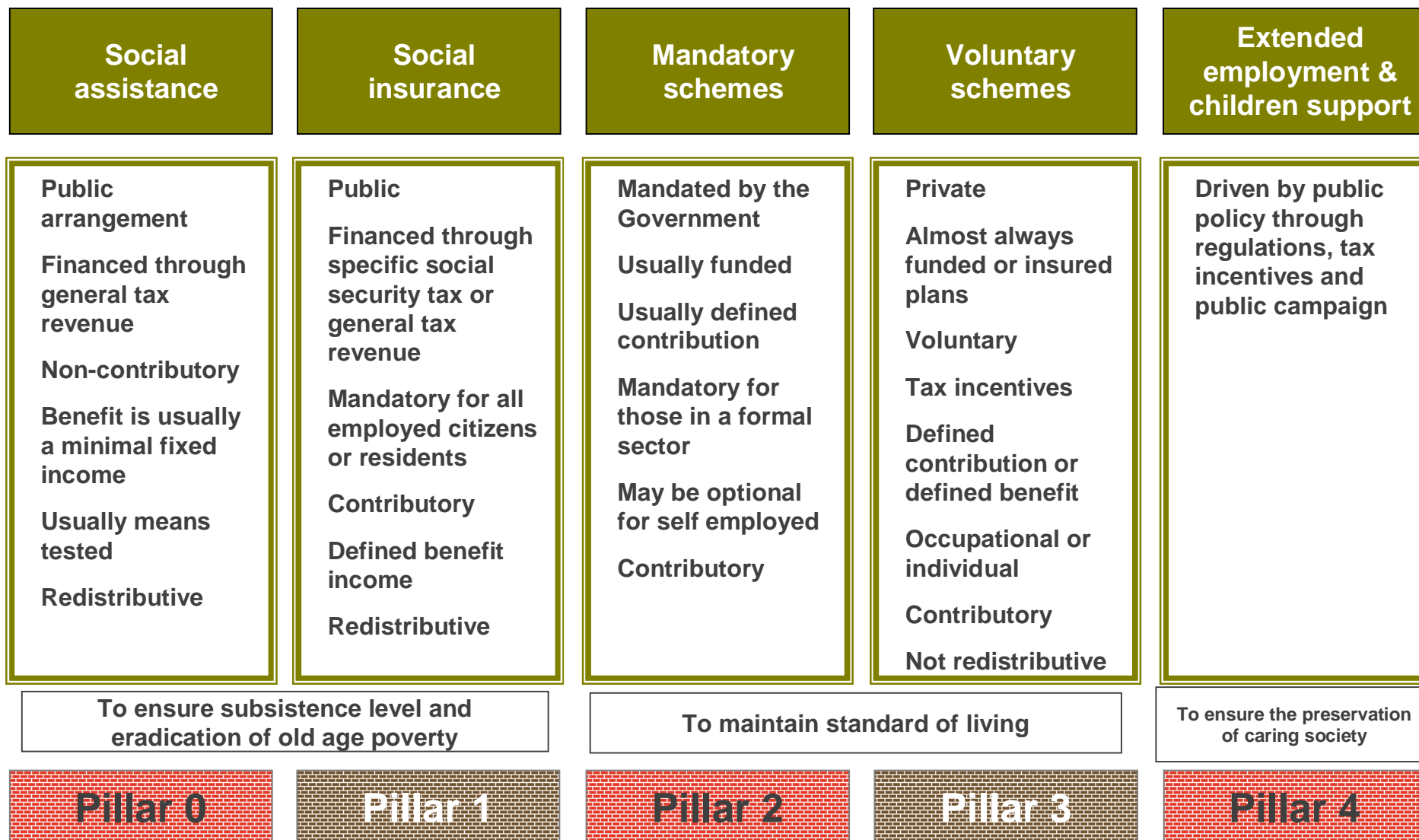
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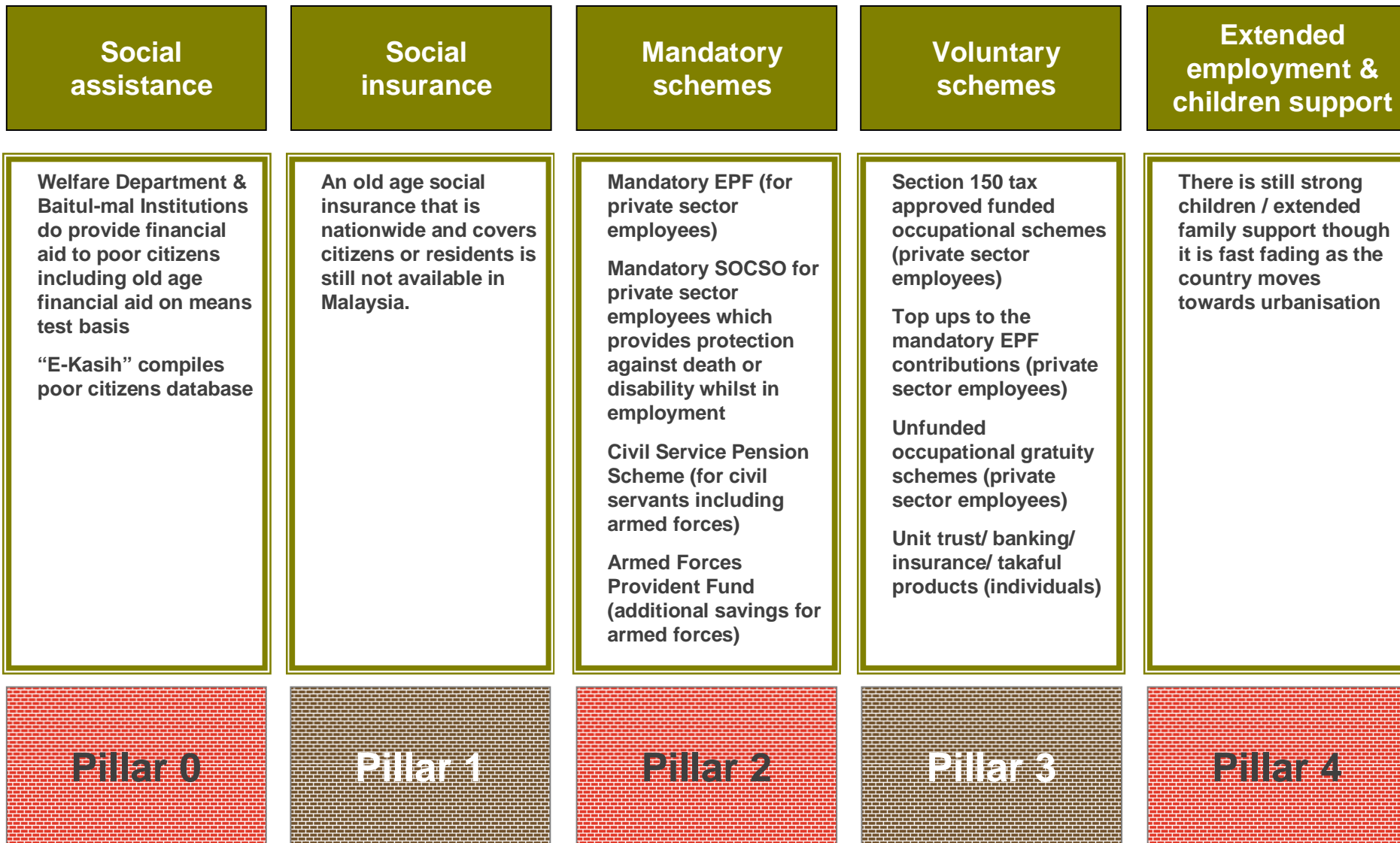
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Multi-Pillar Pension System

Characteristics of A Typical Multi Pillar Pension System



Multi-Pillar Pension System Malaysian Perspective



Social Assistance

Department of Social Welfare and Ministry of Health



Senior citizens financial aid

- RM300 per month aid
- The number of individuals receiving the aid has increased from year to year and in 2009 about 38,000 individuals received the aid totaling RM71 million



Homes for senior citizens

- poor senior citizen aged 60 years old and above
- 13 homes throughout the country
- 2 homes specially catered for those who cannot perform activities of daily livings



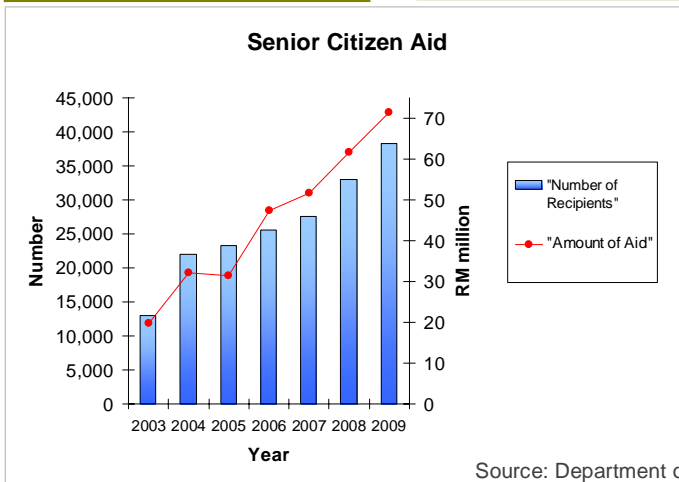
Subsidised healthcare

- Healthcare subsidy is an indirect approach to provide assistance to those in need
- Extensive nationwide government hospitals and clinics providing highly subsidized healthcare

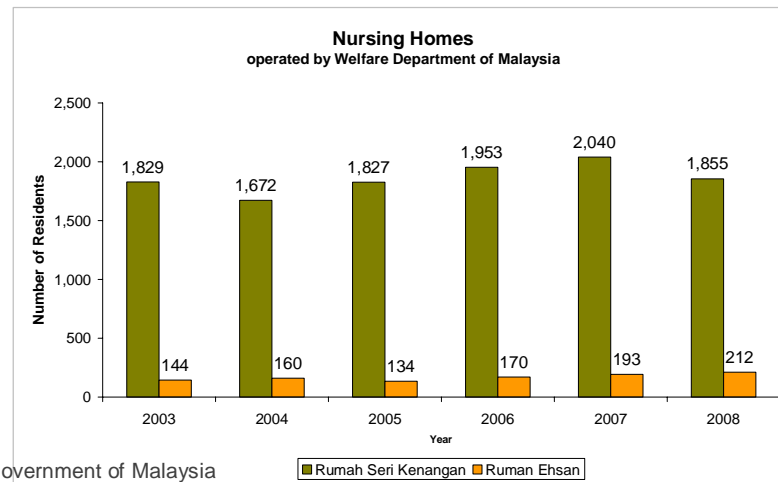


The National Advisory & Consultative Council for Senior Citizens

- Chaired by the Minister, Family and Community Development
- Formulate policy for protection and development of senior citizens



Source: Department of Statistics, Government of Malaysia



Social Assistance

Current Challenges and Actions

- RM300 per month is inadequate given the poverty line of RM720 a month
 - We estimate that RM330 million is required if each of the recipient receiving the aid in 2009 were to receive RM720 per month
- Not all potential recipients are captured
 - If all poor senior citizens are covered we estimate approximately RM1.6 billion is needed in 2010 to provide RM720 a month
- Duplication – recipients may receive financial aid from more than one source
- “e-Kasih”, a central database, is being built up to identify those in needs, coordinate delivery of income support, allocate resources to target groups and prevent duplication (RMK10)
- Outreach programmes to enhance the comprehensiveness of the database (RMK10)
- Increasing healthcare cost and gradual removal of subsidies
 - A safety net for the poor senior citizens is needed before subsidies are gradually removed (RMK10)

Pillar 2 – Existing Structure Coverage

	Civil Service Employees	Private Sector Employees	Self-employed and others
Old age pension	Civil Service Pension Scheme provides government pensioners pension for life from normal retirement age 58	The EPF does not require annuitization of the lump sum received	x
Lump sum meant for retirement purposes	Civil Service Pension Scheme provides a lump sum on top of the pension	The EPF allows full lump sum withdrawal from age 55	x
Survivors' pensions	Civil Service Pension Scheme provides continuation of pension to surviving spouse whether death in service or in retirement	SOCSSO provides spouse's pension for death that occurs whilst the individual is in service and before attaining age 55	x
Contributory	No	Yes	x

- Pillar 2 EPF is currently comprehensive but covers only those employed in the formal sector
- Self employed and housewives are not protected under Pillar 2
- Attempts to extend the coverage to self employed and housewives have been made but we believe that the take up rates are still low

- SOCSSO only provides pension to the beneficiaries if death of a member occurs before age 55 and whilst in employment.

Pillar 2 – Net Income Replacement Ratio expressed in terms of Pension as a Percentage of Last Drawn Basic Salary

	Public Sector Employees	Private Sector Employees	Self-employed and others
Old age pension for life	Pension for full career member is about 60% of last drawn basic salary	n/a	n/a
Lump sum meant for retirement purposes	This adds an additional 13% of last drawn basic salary (if the lump sum is converted to pension at age 58)	For future retirees the lump sum accumulated in the EPF (if converted to an annuity at age 55) can provide post retirement income of about 50% of last drawn basic salary	n/a <small>Note: Assuming 30 years uninterrupted contributions, no pre-retirement lifecycle withdrawals, retirement is at age 55, interest rate 5.5% pa and inflation adjustment of 2.5% pa.</small>
Survivors' pensions	100% of accrued pension to surviving spouse or 50% of last drawn basic salary whichever is higher	50% of last drawn basic salary up to a salary ceiling of RM3000 (only for death whilst in service and before age 55)	n/a

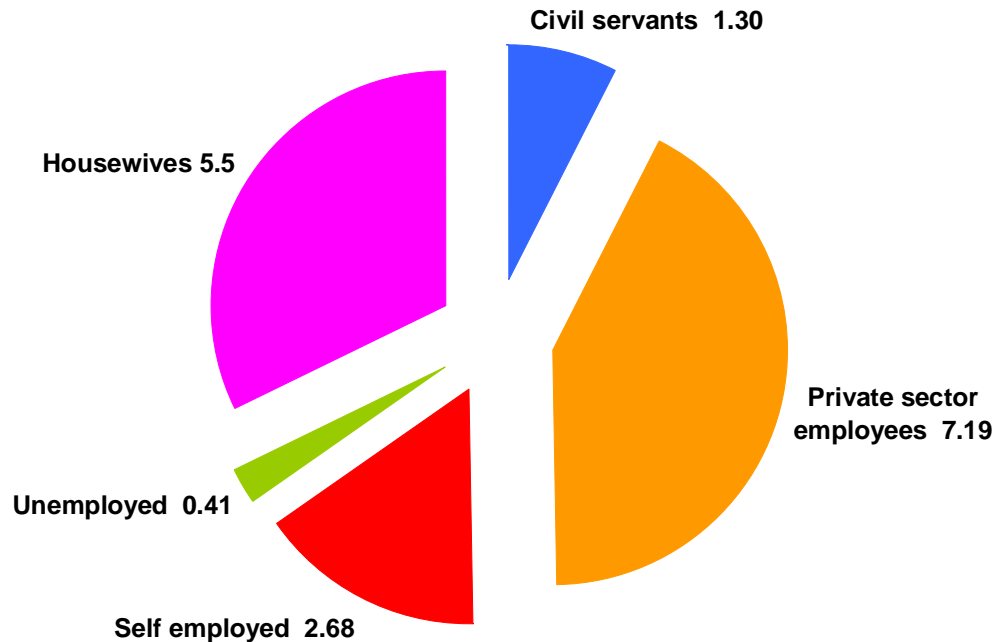
- These together make up a post retirement income of about 73% of last drawn basic salary
- Should allowances (which are not pensionable) make up a sizeable portion of a civil servant's take home pay, 73% of last drawn basic salary would be insufficient to provide a reasonable continuation of pre-retirement standard of living

- For current retirees, amount accumulated at age 55 is inadequate to provide a reasonable level of income to maintain the same standard of living for life after retirement. This is due to low past contribution rates, leakages and low retirement age
- For future retirees, it is expected that the amount accumulated assuming no pre-retirement withdrawals can provide an income post-retirement of approximately 50% of last drawn basic salary. But if the retirement age is extended to 60 the current level of contributions is sufficient to provide a reasonable continuation of pre-retirement standard of living.

The Gap in Pension Coverage

How many people are covered by a formal Pillar 2 system?

Number of people between age 15 and 64 (figures are in million) who are either in employment in one form or another, actively seeking employment or housewives



Source: Department of Statistics, Government of Malaysia March 2010, Ministry of Labour and Mercer analysis

Note 1: The figures exclude students, retired and disabled persons.

Note 2: Self employed includes those who are categorised as unpaid, family workers.

- By definition the EPF and to a large extent SOCSO will capture all private sector employees under its system (except for foreign workers who have opted out, contract staff and part timers)
- Almost all Civil Servants (inclusive of the Armed Forces) are covered under the Civil Service Pension Scheme (just a small fraction of the civil servants are non-pensionable because of non-permanent employment status or have opted to join the EPF scheme instead)
- There is no formal scheme to capture the self employed (estimated to be approximately 2.7 million in number)
- Housewives, estimated to be around 5.5 million in number are dependent on their spouses' benefits. There is currently no pension sharing provision for divorced housewives.

Adequacy of EPF Savings

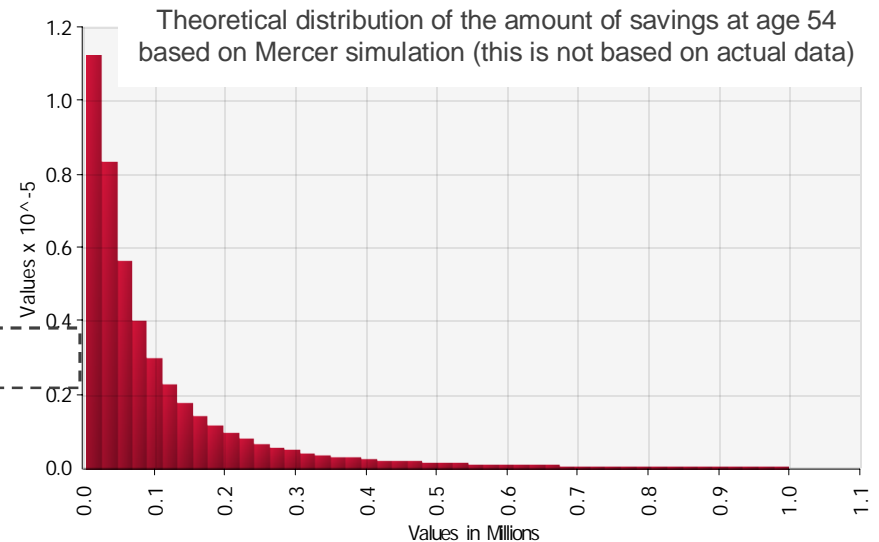
ACTIVE MEMBERS' AVERAGE SAVINGS AT AGE 54 BY SEX

AVERAGE SAVINGS (RM)		
Year	Male	Female
2003	105,621	62,034
2004	112,789	67,686
2005	122,143	73,969
2006	129,563	81,483
2007	138,895	84,956
2008	150,280	96,856
2009	159,253	101,695

Source: The EPF

- Average amount of savings that has accumulated in the EPF accounts for a male member who retires in 2010 is approximately RM160,000
- A female member retiring in 2010 has an average savings of slightly more than RM100,000

- Our own guesstimate of the median savings is about RM50,000 i.e. 50% of members at age 54 in 2009 have less than RM50,000 in their EPF savings



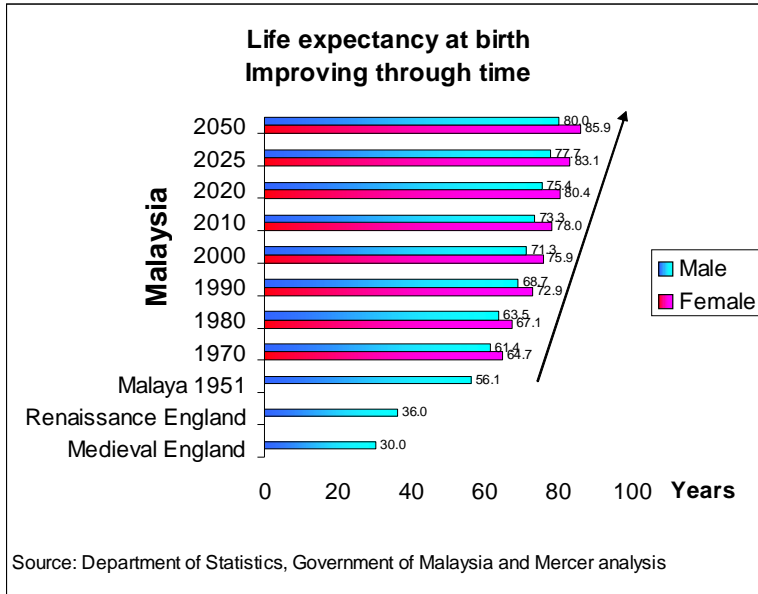
Form of Benefit

Lump Sum, Annuity or Drawdown?

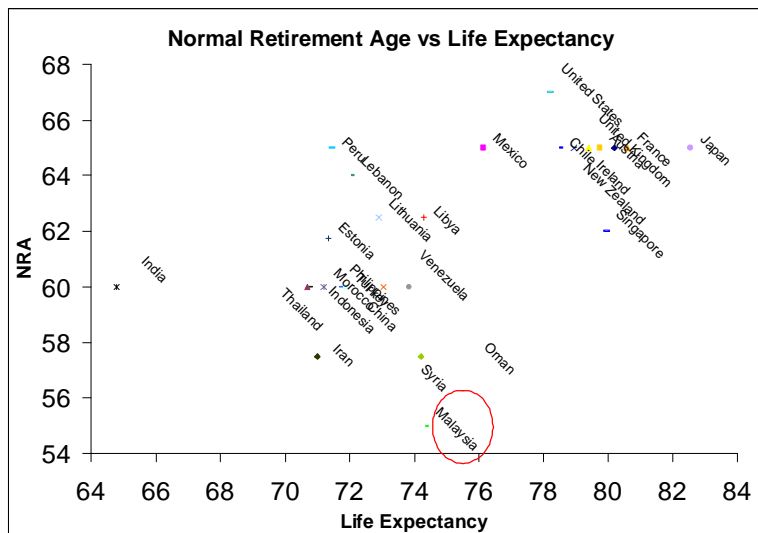
- Lump sum is popular but a study has shown that 70% of retirees use up all their lump sum within 10 years after retirement
- Almost all Pillar II plans around the world require the majority of benefit to be taken in regular income format; mainly to avoid penury for older pensioners
- If benefit is continued to be paid in lump sum there is a risk to the Government to provide financial assistance to retirees who have outlived their savings
- It is being recognised that too few individuals are able to manage their funds after their retirement and too many have been unable to cope with the investment and longevity risk
- Annuity allows pooling of risk
 - Those who die earlier subsidize those who live longer
 - annuity avoids living a long life as a pauper or die young as a rich man



Low Retirement Age



- There is no mandatory retirement age for private sector employees in Malaysia but the normal age at which most private sector employees retire from employment is 55. This is low by international standard.
- The age at which full withdrawal of savings can be made from the EPF is also 55, and has not been changed since the establishment of the EPF
- Retirement ages (and ages at which one can draw their retirement savings) need to be consistent with life expectancy and labour market characteristics
- Civil servants normal retirement age is now 58, having been 55 for many years since independent. It is expected that the Government will eventually increase the normal retirement age to 60.
- However the increase in normal retirement age of the civil service is not echoed by the private sector (except for the quasi-government organisations)

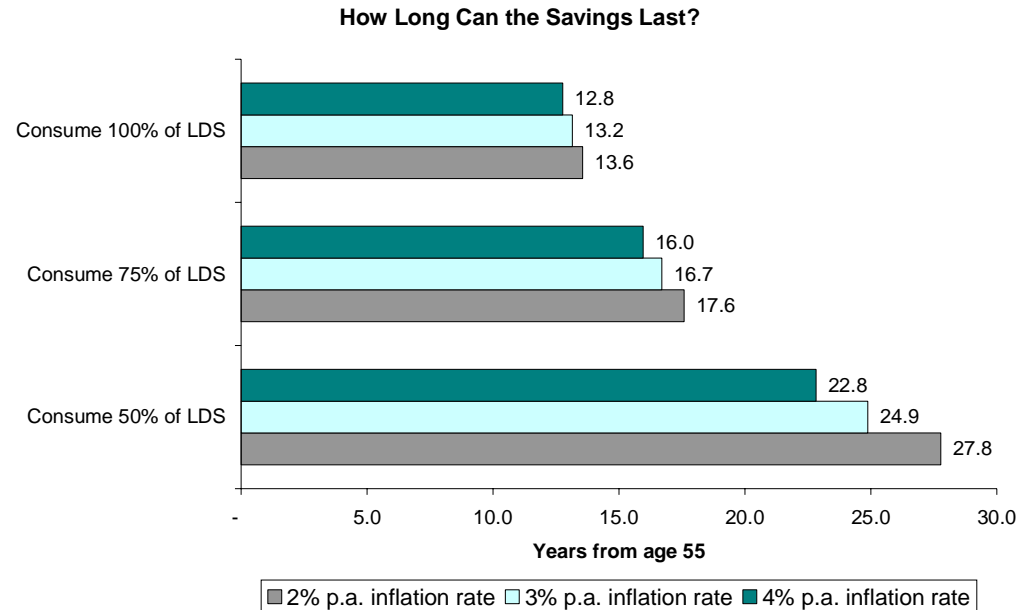


A Simulation on How Long Can the Savings Last

Income Drawdown Approach

Assumptions

- Contribution rates 23% in total for full career of 30 years
 - Retirement age at 55
 - EPF dividend rates are actual to date and for future the dividend rate is at 5.5% pa
 - Assume no pre-retirement leakages of EPF savings
 - Assume initial consumption in first year of retirement 50%, 75% and 100% of last drawn salary (LDS) reflecting income replacement of high income, middle income and low income respectively
 - Interest rate in retirement is 5.5% pa and inflation rate varies at 2%, 3% and 4% pa
- The objective is to see how many years can the EPF savings last



Source: Mercer analysis

- Where 100% income replacement is required, the number of years before savings deplete is about 13 years (i.e. by age 68)
- Where income drawdown at 50% income replacement level, the savings can sustain for about 28 years (i.e. upto age 83) under low inflation projection and 23 years (i.e. up to age 78) under high inflation projection

Pillar 3 – Voluntary Private Sector Occupational Schemes

- Most large companies (more than 1000 employees) in Malaysia do provide additional retirement benefits to their employees in the form of:
 - Top up contributions to the EPF
 - Unfunded occupational gratuity schemes
 - Section 150 tax approved funded occupational schemes or insured schemes

- Almost all are non-contributory

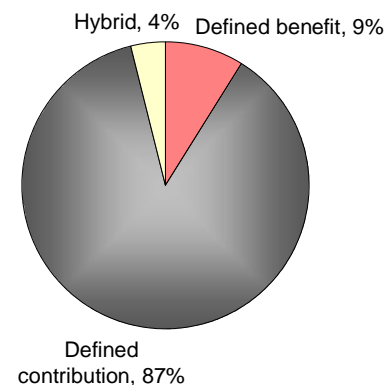
- Defined benefit schemes used to be the dominant scheme but over the past decade more and more schemes have been converted to the EPF top up scheme which is a provident fund

- The number of Section 150 schemes have reduced significantly over the past 10 years. Recent data shows that there is slightly less than 150 schemes that are still around but half of this is estimated to be inactive. Reasons for companies to close their Section 150 approved schemes are:
 - EPF is a low cost alternative
 - EPF is a defined contribution scheme
 - Stable investment performance with a minimum dividend of 2.5% pa which is also extended to contributions in excess of the mandatory requirements
 - More popular as the EPF has housing withdrawal scheme

Do organisations provide retirement benefit scheme in addition to statutory coverage	
Yes	No
41%	59%

Source: Mercer 2009 Survey All Industry (excluding Financial Sector)

Types of Retirement Schemes based on 2009 All Industry (excluding Financial Sector) Survey by Mercer



Tax Framework

Differences between Occupational Schemes

	Top up contributions to the EPF	Section 150 tax approved funded occupational schemes	Section 150 tax approved insured scheme	Unfunded occupational gratuity scheme
Contributions	Employer contributions are tax deductible up to a maximum of 7% of salaries	Employer contributions are tax deductible up to a maximum of 7% of salaries	Employer contributions are tax deductible up to a maximum of 7% of salaries	There are no contributions. Expense charge to profit and loss account is not tax-deductible
Investment income and capital gain	Roll up tax free but is subject to investment restrictions	Roll up tax free but is subject to investment restrictions	Life insurance fund is taxed at 8% and is subject to capital charge under the risk based capital framework	Not applicable since there is no investment income or capital gain under the book reserve approach
Benefits	Lump sum received at age 55 or above is tax free Pre-retirement lifecycle withdrawal before age 55 is tax free	Lump sum received at age 55 or above is tax free Withdrawal before age 55 must be transferred to another approved scheme	Lump sum received at age 55 or above is tax free Withdrawal before age 55 must be transferred to another approved scheme	Tax free provided that employee receives the benefit at age 55 and having completed 10 years of service with the employer

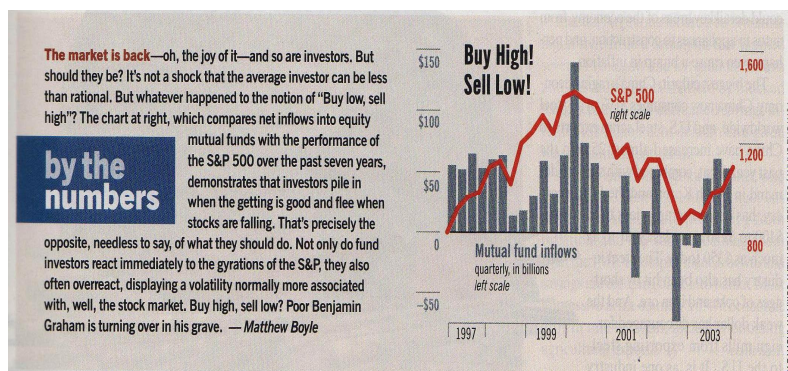
Importance of the Role of Occupational Pension Schemes under Pillar 3 Structure

Occupational scheme

- **Low expense:** Economies of scale can help to lower the expenses of providing third pillar pension
- **Investment advice:** Employers have access to professional advisers which would otherwise be too expensive for individuals to obtain
- **Risk sharing:** Employers can share some risks with the employees by providing some kind of guarantees
- **High coverage:** Employers can devise a pension scheme that maximizes participation
- **Readily existent tax incentives:** The tax framework currently provides adequate tax incentives to spur the growth of occupational schemes

Individual scheme

- **High expense:** Relatively high fee e.g. current products in the market have on average between 1.0% and 1.5% of NAV fund management charge and relatively high distribution cost, Assuming on average a 7% pa gross investment return charges of 1.5% of NAV will reduce the amount available by 20% at the end of a 25 year investment period
- **Investment advice:** Many individuals are ill-equipped to make wise financial decisions
- **You are on your own:** Individuals take on the investment risk
- **Low coverage:** Some product designs naturally exclude individuals of certain income level from entering the system
- **Herd mentality:** Investors pile in when the getting is good and flee when stocks are falling.
- **Lack of tax incentives:** Currently there is insufficient tax incentive for individuals to invest for their retirement



Ensuring and Strengthening the Preservation of Caring Society

- Currently an individual taxpayer can claim of up to RM5,000 a year tax relief for payment of parents' medical bills
 - Is this enough?
 - Should this be extended to other forms of maintenance?



- Should Malaysia consider filial responsibility law e.g. Maintenance of Parents Act?
 - Well the law can compel one to give money to one's parent, but not love and care

- Extensive public campaign and awareness
 - TV advertising can relay a powerful message!

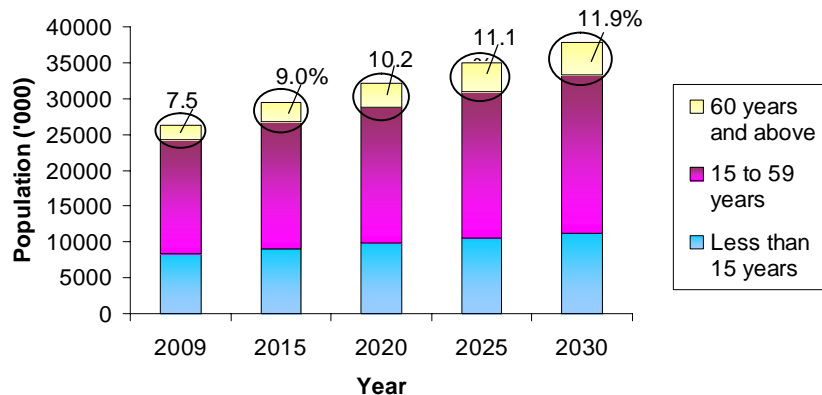


- Improvement on other public policies
 - E.g. improve housing design to make it more convenient for the elderly to live with the children

Ageing Population

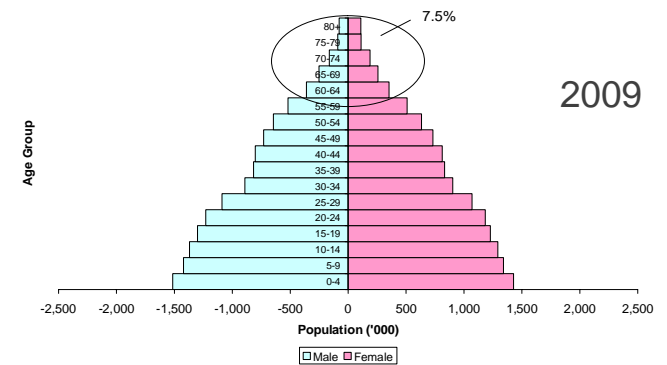
Is time on our side?

Projection of Malaysian Population by Age group



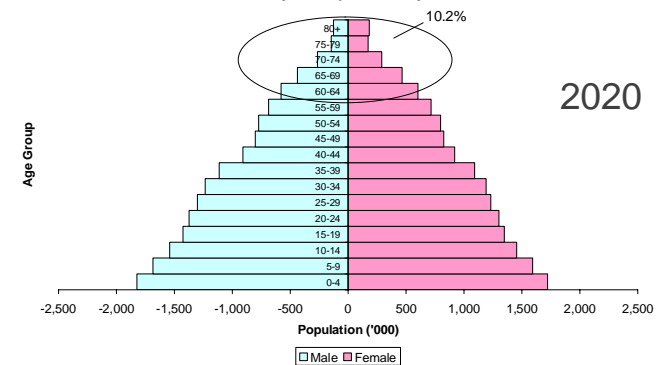
- Malaysia is expected to reach ageing nation status by 2020 when the proportion of population age above 60 years exceeds 10%.
- We have at most another 10 years before issues pertaining to senior citizens inevitably becomes more and more important agenda for the elected Government
- It is important to start plan for the provision of financial protection for the senior citizens now whilst time is still on our side

2009 Malaysia Population Pyramid



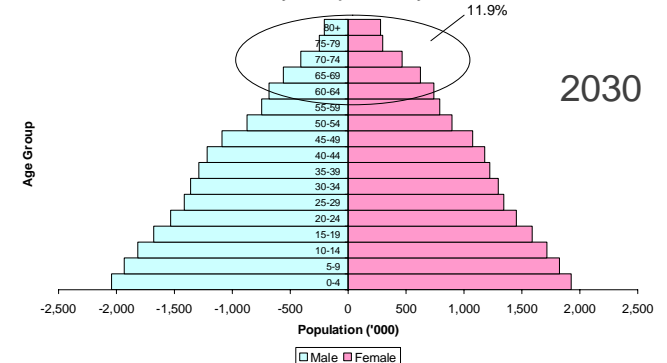
2009

2020 Malaysia Population Pyramid



2020

2030 Malaysia Population Pyramid



2030

The Malaysian Pension Framework

Conclusions

- **Sharing of risk and responsibilities:** Future shape of Malaysia pension system should promote the sharing of responsibilities by all stakeholders. Currently there are elements of a multi-pillar system in Malaysia. The extent to which this needs to be developed into what can be considered as adequate and sustainable multi-pillar model depends on the objectives of the system. There are important roles for the Government, employers and individuals. This is desirable from an equity and a sharing of risk point of view and is the norm in most countries
- **The self employed and their inclusion:** The pension system can incorporate features to encourage their inclusion (or to require it) but other accompanying measures are also required
- **Closing the gaps:** There are currently gaps in retirement benefit provision. Whether and how these gaps are filled depends on the objectives of the system
- **Retirement ages:** These need to be consistent with life expectancy and labour market characteristics. Flexibility in retirement should also be promoted
- **Holistic approach:** Any decisions should not be taken in “silos”. Development of Pillar 3 pension cannot be implemented without the revamping of Pillar 2 structure as currently the latter crowds out the former. The level and form of Pillar 1 benefits will also influence the structure of any revision in Pillar 2 and a rejuvenated Pillar 3.

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