



MYRINGGIT Getting Your Money's Worth

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MYRETIREMENT

BY J. CAMPBELL TUPLING



THE existence of the Employees Provident Fund (EPF) has many people assuming that enough is being saved for retirement. However, the unfortunate fact is that more than 70% of EPF members will exhaust their EPF money within 10 years of retirement.

According to the EPF 2008 Annual Report, the average savings of active members aged 54 – one year before the qualifying retirement age of 55 – is only RM132,540. Assuming a continued 5% investment return, a monthly withdrawal of RM2,000, and no new car purchases or financial assistance to family members, that amount would last just over 6.5 years, a time period far less than the anticipated time spent in retirement.

Taking these concerns into account, there has been an ongoing effort by the government, regulators and other relevant bodies to formulate a plan to provide an additional solution to retirement savings. This article series is aimed at informing and educating the Malaysian investing public on various consumer issues concerning private pensions.

In this first article, we will explore how private pensions can complement current pension systems and the pension framework. The second article will talk about the pros and cons of existing pension systems in different countries. Following that, we will discuss consumer issues and solutions which need to be adopted in developing an effective pension programme, while the final article will shed light on some retirement concerns that need to be addressed and successful policies from other countries.

Witnessing how private pension has evolved and developed, the OECD (Organisation for Economic Co-operation and Development)'s 2008 report *Pensions At a Glance: Asia/Pacific Edition* has identified four reasons why current pension systems are unlikely to deliver a secure income in old age:

1. Coverage of formal pension systems is relatively low.
2. Withdrawal of savings before retirement is very common.

WHEN THE EPF MONEY IS NOT ENOUGH

According to the Employees Provident Fund, many Malaysians will use up their EPF money early in their retirement. Perhaps the creation of private pensions may help fill the gap.

3. Pension savings are often taken as lump sums with the risk that people outlive their resources.
4. Pension payments are not automatically adjusted to reflect changes in the cost of living.

How does a pension system work? In a landmark 1994 report, *Averting the Old Age Crisis*, the World Bank formed the basis for modern pension discussion and development in many countries around the world. The solution prescribed in that report was summed up as the Three Pillar Pension Model. In 2005 this was revised to a Five Pillar Framework:

- 0 Pillar: to provide basic protection in old age to combat poverty.
- 1st Pillar: to replace some portion of lifetime pre-retirement income.
- 2nd Pillar: individual forced savings to combat relative poverty – a fall in consumption following retirement.

- 3rd Pillar: to further supplement retirement income with voluntary, flexible and discretionary retirement savings (3rd Pillar solutions may address gaps, limited coverage and adequacy benefits as 1st and 2nd Pillar schemes may not be effectively reaching the informal working sector).
- 4th Pillar: access to non-financial benefits such as family support, access to healthcare coverage, and home ownership.

Most nations are pursuing development of a multi-pillar pension system with a funded 2nd Pillar based on the employment relationship and 3rd Pillar based on individual initiative. Many Asian countries, including Malaysia, have avoided the 0 and 1st Pillar.

The EPF is the country's nationally managed 2nd Pillar solution. However, it cannot be prevailed upon to satisfy the full income requirements of retirees. It is hoped that the introduction of a 3rd Pillar private pension structure in the coming years will help complement the EPF and enable individuals to accumulate more for retirement.

At first, pension plans were established based on defined-benefit, meaning there was certainty to the amount paid out upon a person qualifying to receive a pension. This means

and reliable manner. It is a defined-contribution public pension plan where employees and employers contribute monthly towards an individual's retirement.

It's been said more than once that Pillar 2 (EPF savings) alone is not enough to meet the total financial needs for many people. However, people need to realise that though it is the primary means for pension savings, the EPF was never meant to fund a retirement lifestyle. It is only meant to help fund basic needs and requirements during retirement.

To meet this goal of funding basic needs and provide returns with more certainty, monies are invested the same way for all members, whether one is 25 or 50, and investment flexibility is limited. Of 2008's total investment portfolio, the EPF invested 40% in loans and bonds, 28% in Malaysian government securities, 26% in equities, 5% in money market instruments and 1% in properties.

An additional reason for Malaysia's Pillar 2 not being able to successfully meet the financial needs of its people during retirement is the country's relatively young retirement age – 55 for both men and women. However, as our nutrition and health standards improve thus increasing life expectancy, Malaysians will spend many more years in retirement.

MULTI-PILLAR PENSION FRAMEWORK SUMMARY

Pillar	Objective	Target Groups			Characteristics
		Lifetime Poor	Informal Sector	Formal Sector	
0	Elderly poverty protection	*	*	*	'Basic pension', needs-based social assistance
1	Elderly poverty protection & consumption smoothing			*	Public pension plan, publicly managed, defined benefit or basic defined contribution
2	Consumption smoothing via minimum pension			*	Fully funded occupational/ personal pension plans
3	Consumption smoothing	*	*	*	Partially or fully funded occupational/ personal pension plans
4	Elderly poverty protection & consumption smoothing	*	*	*	Access to informal – e.g. family support, or other formal social programmes – e.g. health coverage, & individual's assets – e.g. home ownership

NOTE: THE SIZE OF (*) CHARACTERISES THE IMPORTANCE OF EACH PILLAR FOR EACH TARGET GROUP. SOURCE: HOLZMANN AND HINZ, OLD AGE INCOME SUPPORT IN THE 21ST CENTURY.


that however markets performed, the defined benefit pension fund was still obligated to pay out the same amount every year. However, the cost of funding defined-benefit plans became too expensive, and this gave rise to pension plans based on defined-contribution. In a defined-contribution pension programme, the pension benefits are a function of the contributions, investment performance and tax.

With defined-contribution, the individual assumes the investment risk, similar to how an individual assumes investment risk when investing in unit trust or investment-linked funds.

Formed in 1951 and governed by the Employees Provident Fund Act 1991, the EPF provides retirement benefits for members through management of their savings in an efficient

The implication is that the same number of years spent working and saving for retirement will need to support more retirement years than before. This will naturally decrease the likelihood that one will have enough money to last the entire length of one's retirement.

The emergence of a properly structured Pillar 3 private pension system will help address some of these retirement gaps and help those not covered by the EPF to further commit to voluntary savings.

In the next article, we will do a quick tour of the region and the pension plans available in different countries. 

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