PM, Aug 09

How to maximise your EPF

By Tho Li Ming

IF YOU ARE young and your biggest cares are your car loan and financing that shopping spree coming up, retirement may be the furthest thing from your mind. Yet, it is making the right decisions today that will make it affordable for you to retire.

In terms of retirement, the EPF is likely to be the bedrock of a working Malaysian's funds. So, how do you make the best use of your EPF funds in terms of growing it, using it to boost your wealth and making it last as long as possible in your retirement? We look at how we can capitalise on some of the initiatives that the EPF introduced under its Beyond Savings programme. Contrary to common perception, you can invest in stocks, and buy a property that is not your primary residence.

GROWING it

Invest it? No, thanks, some people will say. If you are one of them, that's fine, as long as you are aware that it probably means saving more or working longer to compensate for the effects that inflation will have on your nest egg.

And even then, not everyone should invest. You might be better off leaving your money in the EPF if you don't have the necessary knowledge and skills to invest.

"Remember, when you're taking out your money to invest, you're taking on more risk, so you need to know how to manage it. Otherwise, it's just like going to war without knowing what strategy to take," says Robert Foo, financial planner and principal consultant/managing director of MyFP Services Sdn Bhd.

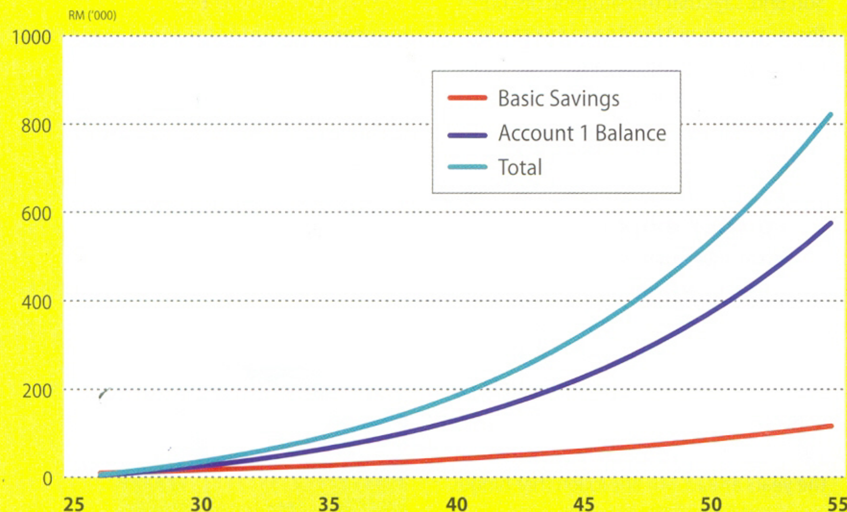
Older people who don't have the luxury of a longer investment time horizon should also think twice, especially in the current environment, says Cheong Kim Chee, financial planner and executive director of OptiPLAN Sdn Bhd.

For those with bigger risk appetites, however, the EPF's Beyond Savings initiative now allows you to invest more, starting at a younger age. There are now two accounts: Account I will be strictly meant for retirement income and makes up 70% of the total contribution while 30% can be used for pre-retirement withdrawals (Account II). The "basic savings" component (Account I) is where an amount is set aside progressively to enable members to accumulate a minimum savings of RM120,000 upon reaching 55. This amount cannot be withdrawn. But an option available since February 2008 allows members to invest up to 20% of the amount in excess of their basic savings amount in Account I, in products from 39 approved investment institutions. Investments can be made once every three months with a minimum amount of RM1,000.

If you wish to maximise the amount you can invest, by withdrawing at a consistently periodic rate you will get the most out of your funds.

The experts agree that this move is better for younger EPF contributors. "Before this new structure, anyone below 35 would find it difficult to withdraw because you need to

When can you invest?



Scenario is based on a 25-year-old who commences work earning RM2,000 per month. He receives an increment of 6% yearly, and 5% pa returns on his EPF funds.
He is first eligible to invest at year 5 (age 29). Account I has RM24,679, which is RM8,679 in excess of the basic savings amount of RM16,000. 20% of that amounts to over RM1,735 (RM1,000 is the minimum investment amount)
(note: illustration above assumes no withdrawals have been made)

Required basic savings in Account I

Age (years)	Basic savings (RM)	Age (years)	Basic savings (RM)
18	1,000	37	34,000
19	2,000	38	37,000
20	3,000	39	41,000
21	4,000	40	44,000
22	5,000	41	48,000
23	7,000	42	51,000
24	8,000	43	55,000
25	9,000	44	59,000
26	11,000	45	64,000
27	12,000	46	68,000
28	14,000	47	73,000
29	16,000	48	78,000
30	18,000	49	84,000
31	20,000	50	90,000
32	22,000	51	96,000
33	24,000	52	102,000
34	26,000	53	109,000
35	29,000	54	116,000
36	32,000	55	120,000

accumulate a minimum RM50,000 in order to withdraw to invest," says Cheong. "The new structure is better because if you follow financial planning principles, when you are young, you can take on more risks as you have a longer time horizon."

Another avenue for investing is indirectly in the local stock market through designated fund managers. Among the fund managers that offer this option are Phillip Capital Management Bhd and Apex Investment Services Sdn Bhd. For Phillip Capital, one needs RM10,000 to open an account. Through this scheme, investors are sometimes given a choice of whether to select the stocks they want or to take the discretionary approach and invest in a basket of stocks predetermined by the fund manager. Foo says the latter is a good option to take, although when it comes to returns, they may not be that different from that of unit trusts.

"Compared to investing in unit trust funds, the returns are usually about the same. This is because they are playing the same market and using the same techniques. Although using discretionary funds may be better than investing on your own, generally speaking, most people will choose to use the fund to speculate, and the weight of evidence is that you will probably not get the returns from it. If you have the time to do that, you should start your own fund house."

Cheong agrees. "Personally, I feel that this is more suitable for those who have experience investing in stocks directly. Those who do not may get distracted and invest more than they are able to, as people tend to invest larger sums using their EPF money rather than when using cash.

"However, it is an option that people should use, but make sure your fund manager has a reasonable track record." ■

SUCCESS STRATEGIES

Look at the big picture

Given the EPF's conservative portfolio, withdrawing to invest in equities is one way to balance the scale. This is especially suitable for someone who is relatively young and can take on more risks.

A way to decide how much to withdraw is to look at the EPF as part of your total portfolio. If it forms the bulk of your portfolio, then you can afford to withdraw and invest more aggressively. Conversely, those who are already investing a significant portion of their extra savings might want to keep the EPF funds where they are, says Robert Foo, financial planner and principal consultant/managing director of MyFP Services Sdn Bhd. "If you're already taking risks with your cash and you are using the EPF as a conservative investment portion [of your portfolio], then you might not want to make any withdrawals."

However, Cheong Kim Chee, financial planner and executive director of OptiPLAN Sdn Bhd, says that this situation discounts those who are not looking to invest any part of their EPF funds in anything. "Those who don't want to touch their EPF money should still have a separate portfolio, perhaps focusing on retirement."

Keep your eye on the goal

As with all investments, active management and monitoring of your own funds is required, especially in today's market. Rajen Devadason, financial planner with MAAKL Mutual Bhd and CEO of RD WealthCreation Sdn Bhd, says market volatility is high and is likely to increase in the years ahead. "An approach that hinges upon active dynamic asset allocation and reallocation is likely to do better than a mere buy-and-hold strategy."

Foo uses the analogy of a football team to further explain. "As with a football team, always have a plan. If two goals are enough for you, you must have adequate defenders to defend your returns. Rebalancing is important. Since the returns of the EPF averages out to about 5%, that should be your benchmark [target return]. Aim to get higher than that, because you have to factor in the management costs," says Foo. "If you hit the return you need, you should rebalance when the time is right." If your three funds have already made 30% to 40%, and historically, you know that it makes 8% to 10%, you can take profit, he says, adding that investors should bear in mind that unit trusts are meant to be held for a longer term of about five years.

Although managing a unit trust fund portfolio will require taking an active stance in terms of performance monitoring, Cheong says it doesn't need to be managed on a micro level compared with investing directly in stocks, adding that managing the portfolio would be the job of the fund manager. However, keep an eye on the fund manager to see if he is doing his job right.

Spread your bets

In order to spread out the risks appropriately, diversification doesn't just stop with different asset classes but also with fund managers, says Foo. "It doesn't make sense to put your eggs in one basket in today's world of Madoffs. As credible as a fund company may be, it's still better to diversify to at least five fund managers."

However, dollar cost and don't dabble in too many funds if you're just starting out,

FOONG: If you are nearing retirement in two years' time, then you should refrain from investing aggressively

The difference the rate of return makes

> "If you have **RM100,000** that grows at the rate of 5% a year for 20 years, you will end up with **RM265,330**. If it grows at 6%, you will have **RM320,714**."

says Cheong. "Start small. Invest in a fund company that gives you a good range of 10 to 12 funds, [so that] if you need to do switching or portfolio adjustment, you can do it for free."

Wind down when nearing retirement

Those who are older should consider their age and time horizon. "You must try to be aggressive at the beginning and when you're nearing your retirement, you should start defending," says Foo. "If you are nearing retirement in two years' time, then you should refrain from investing aggressively," says Alex Foong, deputy president of the Malaysian Financial Planning Council.

Lifecycle funds may be an option for the uninitiated. Lifecycle funds vary their asset mixes among stock, bond, and money market funds to take a more conservative stance as they approach a target date. Cheong says they may be a good option for those who can trust the fund manager to manage their money for them. "The only thing is that they have no control over their asset allocations. However, either way, they still have to take some form of active interest and find out whether it's going according to the strategy because of market changes." ■

Investing in a HOUSE

There are three types of withdrawals when it comes to investing in a home — when members buy or build their houses; withdraw to reduce their housing loan on a yearly basis; or make monthly instalment withdrawals. It's important to note that the monthly withdrawal scheme is distinct from the annual withdrawal scheme.

The monthly withdrawal scheme is to help pay for the monthly instalments of your housing loan whereas the annual scheme helps reduce the amount of interest charged by reducing the principal loan amount.

Under the monthly withdrawals, members with a minimum balance of RM600 in Account II can withdraw their savings to make monthly payments towards their housing loans, where the minimum monthly withdrawal is RM100 for a period of not less than six months.

Under the yearly housing withdrawal, members can withdraw a minimum of RM500 a year from the last withdrawal date. Note, however, that conditions differ between the two withdrawals; the annual withdrawal can be used on a second house (provided that the first house has been sold) while the monthly withdrawals is restricted to one house for each member. The subsequent monthly withdrawals may only be made for the same house if there is still an outstanding loan amount.

In determining whether to withdraw to pay your loan, look at its interest-rate charges. "If you're talking about reducing your housing loan, which is charging you a higher rate of interest than the return the EPF can give you, then it makes sense [to withdraw]," says Robert Foo, financial planner and principal consultant/managing director of MyFP Services Sdn Bhd. "If the EPF is the lowest cost asset you have, and withdrawing it reduces the cost of borrowing [from the bank], then you might want to consider it."

DEVADASON: Even if the cost of a bank loan is marginally below the EPF's dividend rates, I believe the emotional and psychological benefits of paying off your home and owning it outright far outweigh the slight interest rate differential

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However, one can disregard the numbers when it comes to looking at it from the security and emotional points of view. "In my opinion, this is because the peace of mind that comes from owning a home outright as fast as possible is incomparable," says Devadason.

"Even if the cost of a bank loan

is marginally below the EPF's dividend rates, I believe the emotional and psychological benefits of paying off your home and owning it outright far outweigh the slight interest rate differential," adds Devadason.

"However, if a person is in poor health and has insufficient insurance coverage, then he or she might need to use Account II funds to pay for medical bills later on. In such rare circumstances, keeping some funds in the EPF's Account II is the prudent thing to do."

Devadason advises most of his clients to use the annual withdrawal scheme, instead of the monthly option, to pay off the mortgage on their primary residence. "Note that because the money comes from the same pool, your Account II, it is impossible to harvest meaningful sums of money by using both withdrawal options at the same time."

"If the EPF monthly withdrawal option is used, a lot of people have a tendency to 'cheat themselves' — seeing as the money is banked straight into their account — and won't be using their non-EPF cash flow effectively," says Devadason.

Which option is better, from a financial perspective, depends on the interest rate differential, adds Devadason. "If the cost of the bank loan is lower than the EPF's dividend rate, it's better to keep the money in the EPF longer and to use the annual withdrawal option."

Note that members are allowed to use the monthly and yearly withdrawals simultaneously and are not required to reside in the properties. Thus you could theoretically opt to use it for property meant for investment purposes. ■

Upon RETIREMENT

Studies by the EPF have shown that 70% of members who withdraw their funds in a lump sum spend all of it in less than 10 years. So how do you maximise your funds while in retirement?

The latest Beyond Savings initiative allows members aged 55 to withdraw a lump sum, or in periodical or even monthly payments until their funds run out. Nik Affendi Jaafar, general manager of public relations of the EPF, says members can even opt for two types of withdrawals or more. "You can have a mix of all — withdraw lump sum, then monthly. For example, let's say you have RM100,000, you want to withdraw RM20,000 for a holiday, you can. This will give you a balance of RM80,000. Then you might want to withdraw another RM5,000 under periodical [with a minimum 30-day interval] and then decide on having RM2,000 in monthly withdrawals for a minimum of 12 months.

"As soon as you pass the minimum interval periods, you can change your mind whenever you want. It is now more flexible compared with the old structure," adds Nik Affendi.

Devadason says which option you take will depend on your ability to manage your funds. "If you are able to manage your funds wisely or are able to entrust the management of those funds to a competent unit trust adviser or licensed financial planner, then withdrawing all the funds at age 55 makes sense.

"However, for those who are unsure of what to do, and who, especially, lack the skills needed to manage their funds wisely, drawing monthly sums from the EPF is the safer, albeit probably lower-yielding, option."

How much you can withdraw depends on several factors like the amount of funds, your rate of return and the number of years the funds are required to last. Working this out will help you figure out the lifestyle you can realistically afford to maintain. ■

How much can you withdraw?

"Let's take the earlier case of the 25-year old who works for 30 years (see page 55). The balance in Account I of RM575,219, if made to last 20 years and with a return of 5% pa, will give him **RM3,796** a month, which is 35% of his last-drawn salary (RM1,732 in today's ringgit at an inflation rate of 4%). If he does not withdraw from Account II at all, the total amount of RM821,742 will provide him with **RM5,423** a month, which is 50% of his last-drawn salary."

Be more conservative

Should you decide to withdraw a lump sum and manage the money yourself, the experts advise that you adopt a more conservative portfolio. "A portfolio with the aim of conservation of principal with steady income would be suitable. There is no point being overly aggressive. You can invest 30% each in unit trust funds, stable stocks like plantations and banking, and liquid cash. For members who have yet to insure themselves medically, they can also look at using part of their remaining percentage to purchase a policy before they reach the age of 60," says Mohamed Akwal Sultan, vice-president of the Malaysian Financial Planning Council.

Even though it may seem as though you can afford to, avoid making major commitments or gambling on your funds. "They shouldn't go into speculating in properties because it's a dangerous thing to do, especially as investments like that are not easily liquidated," says Mohamed Akwal. The EPF has said that by January 2013, it will restrict withdrawals for those who do not have a minimum of RM90,000 in Account I at the age of 50.

But keep some equities in the mix

Devadason says if you plan to retire well before you turn 60, it is important to retain some portion of equity exposure in your overall portfolio to generate long-term growth rates that beat inflation. "This is because the official retirement age in Malaysia is still the 'prehistoric' 55, which is utterly untenable in light of lifespans extending well past 80. As you age through your 60s and 70s, there needs to be an increasing shift toward safer assets like bonds, money market funds and fixed deposits."

Planners like Cheong Kim Chee, financial planner and executive director of OptiPLAN Sdn Bhd, suggest that an annuity or annuity-like scheme should form part of your retirement portfolio, which will provide you with a steady income throughout your life. "This scheme is to protect you against your own weaknesses and limitations. I would recommend that you invest 10% to 15% of your portfolio in annuities. However, bear in mind that annuities cannot be compared to an investment vehicle." As an example, immediate annuities can expect returns of 2% to 2.5%, she adds.

However, Foo says: "Unless you feel that you're comfortable with a low rate of return and you have no other option, I wouldn't recommend it. I feel that the local ones are not innovative enough to take care of the different retirement solutions retirees seek and the returns are not attractive."

Accumulate knowledge

The best approach to handling your money begins with arming yourself with the adequate knowledge, say the experts. Devadason says EPF contributors should spend at least five years prior to retirement reading up on and studying personal finance. "Today, there are more than 100,000 life insurance agents and more than 60,000 unit trust agents — of varying quality — in Malaysia. It is imperative for each pre-retiree to realise that no one cares more about his retirement than he himself. The onus is, therefore, on self-education."

Whatever the types of withdrawals members choose to take up, they should be on heightened alert when it comes to blindly accepting offers of investing in risky products or business schemes. As prime targets for unscrupulous sales people, they should avoid the lure of get-rich-quick schemes, Cheong says. "Any business requires [doing some] research first. Start on a smaller scale first and ideally, start building it before you retire." ■

AKWAL: [If you're older] don't go into speculating in properties because it's a dangerous thing to do, especially as investments like that are not easily liquidated

CHEONG: I would recommend that you invest 10% to 15% of your portfolio in annuities. However, bear in mind that annuities cannot be compared to an investment vehicle

NIK AFFENDI: You can even opt for two types of withdrawals or more

Personal Money EPF Poll

The usage of EPF money withdrawn to invest in unit trust funds has been an area of much contention. So *Personal Money* decided to ask its readers how they fared in this endeavour, and how they managed their investments. On top of that, we also asked them how they used their EPF funds for other purposes and for suggestions that they might have for the EPF.

The EPF online straw poll was conducted over a one-week period in late June. The poll was sent out to *Personal Money* subscribers and readers. Out of a total of 353 respondents, 70% were male. The largest groups were aged 25 to 34 (45%) and 35 to 44 (34%).

Many of the respondents were strongly independent. Eighty percent said that they didn't expect their EPF funds to be enough for their retirement, but when asked what should be done about it, many said it was their responsibility to save and invest on their own to make up the shortfall. Many also said they had started saving early with that in mind. When asked what could better improve their investing returns, 55% said they would need to do more research before investing.

When it came to dividends, 56% said the returns were average while 35% thought they were poor. Many wanted to see more transparency in reporting on management of funds and higher standards in corporate governance. ■

Withdrawals

77% of those surveyed had made withdrawals made from their EPF accounts. Those who did not cited the following reasons:

"Unit trusts aren't foolproof, hard to pick winners".
— Deputy director, Selangor

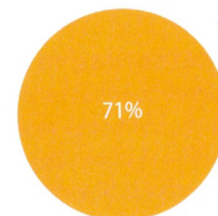
"I choose not to tap into my EPF account as to-date, the EPF has generated small but consistent returns. I do invest in unit trusts and stocks using any spare money that I can accumulate."
— Engineer, Selangor

"[My] EPF fund is for long-term savings. The money we save in EPF should stay there long until after we are retired." *— Editor, KL*

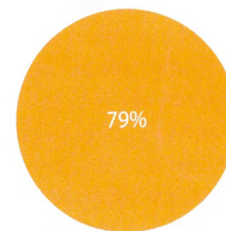
"I have seen the ups and downs of the unit trust values and would not be able to stomach it if I were to see my entire retirement sum lose value."
— Engineer, Selangor

"Happy with EPF returns so far."
— Engineer, Penang

The purpose of withdrawals:



To invest in unit trust funds



To pay for my house/reduce housing loan

1%

To pay for my /a family member's medical expenses

1%

To fund my children's education

6%

To fund my own education

Suggestions for EPF

Respondents were mixed when asked about EPF's existing permitted withdrawals with regard to flexibility of withdrawals and conditions imposed. Forty-six per cent thought the conditions were strict enough, 33% thought fewer conditions should be imposed, while 11% thought more conditions should be imposed. Many were happy with the improvements in services.

Here's what some would like to see done to improve withdrawals:

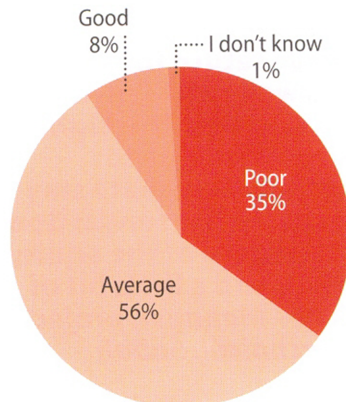
"Online transactions through EPF web portal should be allowed for EPF accountholders to buy or sell their funds (move in and out of EPF fund), without needing to depend too much on the unit trust sales agents."
— *Lecturer, Selangor*

"I have no issues with EPF withdrawals because they were consistently efficient when I did my withdrawal for my house. The processes were simple enough to understand, and the officers guided me on my first withdrawal, easing my anxiety about paperwork and queues."
— *Corporate affairs manager, KL*

"Remove withdrawal for medical purpose. Use EPF money to buy insurance to cover critical illnesses and hospitalisation. Withdrawal for medical purposes may wipe out the entire Account II but withdrawal to purchase insurance needs just a small portion of it but you get bigger coverage. Review and/or tighten withdrawal conditions to invest in unit trust. EPF should review the list of approved unit trust funds annually as a guide for contributors. Those non-performing funds should be taken out from the approved list. EPF should take up a more advisory role." — *Investment planner, Penang*

Investments

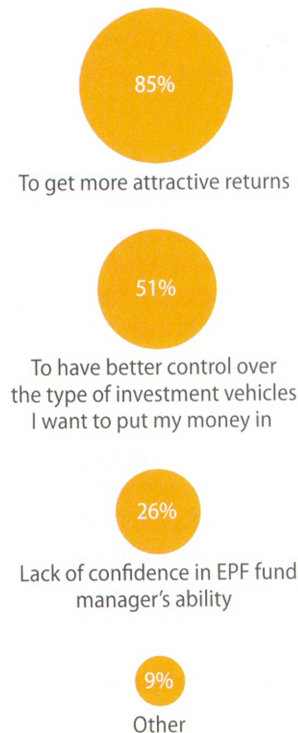
How they rated the EPF's dividend payout rate



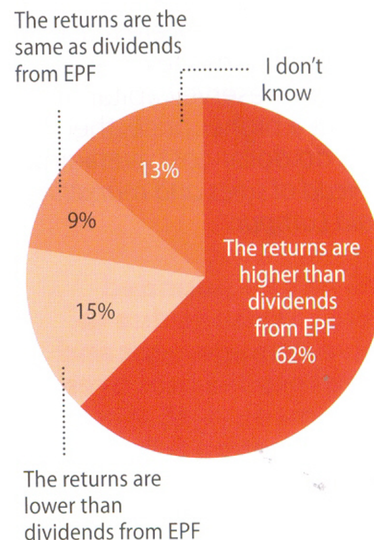
Those who withdrew to invest went into:

The most common approach was dollar cost averaging (49%) and active investing, choosing when to invest and when to rebalance (43%). Some did both. About 22% invest when prompted by their advisers.

The main reason for withdrawing money from the EPF to invest was to get better returns



And most reported that their investments were doing better than the EPF's



Their returns and how they achieved them:

"My investments average about 10% pa returns. I normally set a target growth and exit when I have achieved it." — *Bank officer, Sarawak*

"Overall 2% to 3% higher than what EPF has given. Mainly by timing of reinvestment and switching between equity fund and bond fund. However, timing is not accurate." — *Senior manager, Terengganu*

"8% pa returns, through consistent investment quarterly by applying dollar cost averaging and rebalancing when returns are 15% to 20%." — *Insurance agent, Selangor*

"Average return was about 6% pa. I invested in equity income funds." — *Business owner, Selangor*

"More than 70bps higher than EPF returns. I only withdrew and invested during bearish market, during bullish market, when my targeted returns were reached, I switched to money market funds to preserve capital. If I buy at a higher price, then must do dollar cost averaging." — *Head of sales and marketing, Kuala Lumpur*

"8% pa compounded average returns due to active management and being focused (not over-diversified). — *IT, IS, Administration & Business Process Re-engineering Specialist, Selangor*

In general, some equity funds are higher, but some are in the negative territory. — *Contract manager, Selangor*

"Previously, before the economy took a dip, the average return for all my funds was 18%. Currently, it is 6% or 8%. The higher returns were due to: Length of time that I stay invested in the funds; Good performance of the equity market; and a little bit of luck." — *Manager, projects and technical, Sabah*

Accordingly, most were satisfied with their investment decisions (21% were very satisfied and 57% satisfied).

To be better investors, most respondents said they should do more research (55%), and have better financial advice from professionals (37%). Here are suggestions they had regarding withdrawals for investment:

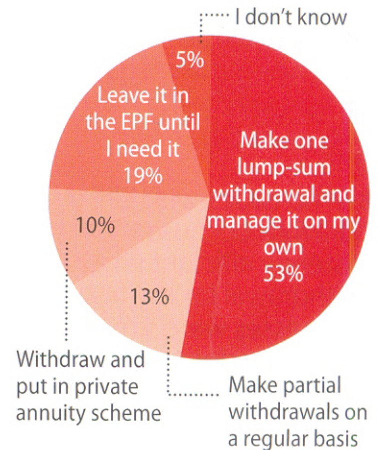
"Allow investments in foreign unit trusts and foreign stocks." — *Business owner, Penang*

"I would prefer to be able to invest monthly rather than quarterly, to help me maximise the DCA [dollar cost averaging] effect." — *Network and telco specialist, Selangor*

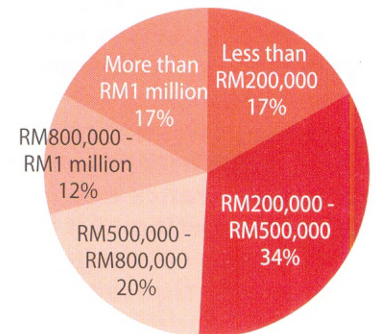
"Instead of three months' withdrawal interval, make it more flexible. Maybe still limit transactions to four a year, but you can exercise the withdrawal right any time when prices are more attractive." — *Consultant, PJ*

At 55

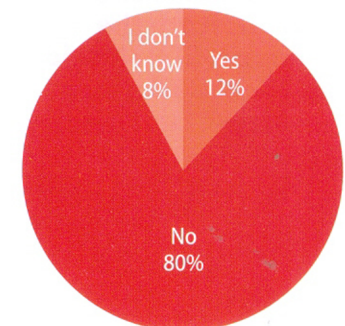
Their plans for their EPF money when they reached 55:



How much they expect to have in their EPF funds upon retirement:



Whether they thought their EPF money would not be enough for their retirement:



Here is what they say they are doing about retirement funding, or think the government or EPF should do

"Liberalise the financial sector so that more savings/ investment instruments can be made available for future retirees to invest in."— *Training manager, Selangor*

"I would encourage the EPF to provide more flexibility in the withdrawal of EPF funds for property investment." — *IT consultant , KL*

"We should follow the European countries where the government takes care of the citizens," — *Commercial manager, Kuala Lumpur*

"I should able to do better myself. Too many restrictions on investment in unit trusts as only a few equity funds are open to EPF investment. The rest are bond and money market, which are not much better than EPF." — *Senior manager, Terengganu*

" I invest the allowable portions. Otherwise, I discipline myself in not withdrawing a single sen until I reach 55. The government should discontinue EPF withdrawal for home financing as people tend to misuse it. This can be critical, as they are touching their *simpanan hari tua*." — *Engineer, Melaka*

"Increase the contribution to EPF." — *Financial adviser, Selangor*

"I don't think it's the government's job to ensure the EPF is enough to sustain a person after his retirement, because it heavily depends on how the person saved and earned during his working years, and also on his consumption habits. Bad consumption habits will wipe out a person's EPF within a few years of retirement. Everyone should take their own financial situation into their own hands and do proper planning from the very start. Everyone should plan their own money. After all, only you know best." — *Engineer, Melaka*

"I already have retirement savings— in terms of residual income from stocks, unit trust and property. EPF could explore schemes with insurance companies or the government to have something that is similar to a government pension scheme." — *Procurement manager, Selangor*

"I think people should generally be responsible for their own retirement planning. If the government needs to step in, I think the best way is to make financial education compulsory for all students, making it an on-going subject that runs from primary to secondary school." — *Analyst programmer, Selangor*

"Government should introduce a more flexible contribution plan to encourage people to save during their working life." —*Financial adviser, Penang*

"Create an annuity scheme managed by EPF, not insurance company." — *Retiree, Selangor*

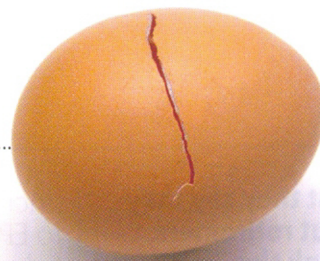
Here are some of their thoughts on transparency:

"Business, government and politics should not mix. There is not enough transparency with regard to how EPF funds are being managed." — *Systems analyst, Penang*

"Could be better, just like what is reported in the unit trust annual reports." — *COO, KL*

"Should be more transparent and publish all its investments online." — *Accountant, Kedah*

"The yearly report should also list how the various external fund managers are performing and explain why/how they were appointed. — *Division manager, Penang*



Pension fund WOES

By Norzuhaira Ruhanie

Retirement funding is a big business that has been going through some rough times in the past few years. Pension funds worldwide are facing issues — such as the growing cost of social security, fund-solvency issues due to longevity and declining birth rates, and the juggling of risk management and investment returns.

The global financial crisis also exacerbated the situation. Reuters reported on July 1 that Japan's Government Pension Investment Fund (GPIF) had posted a record loss of almost US$100 billion (RM352 billion) in its financial year ended March, thanks to the financial crisis and the sharp appreciation in the yen. GPIF's rate of return from investments fell to -10.03% for the year. In the US, many workers with 401(k) plans saw their contributions being wiped out by falling stock market prices last year.

While retirement funds usually have long-term investment horizons that allow it to recover from market swings, short-term losses can eat into the funds and affect payouts in the long run. Is the EPF at risk?

The structures

First, it is important to note the differences between defined benefit and defined contribution plans. The EPF is one of the latter, where a worker is made to save a portion of his take-home salary each month at a set rate in a provident fund while his employer contributes to the fund as well. The money from all members is pooled and invested and members receive dividends to add to their retirement kitty.

Many retirement funds, especially in the developed world (such as Norway's Government Pension Fund), adopt the defined benefit scheme approach, where how much you receive is defined. Hamadah Othman, Mercer Zainal Consulting Sdn Bhd's actuary specialising in pensions and benefits, explains that a defined benefit means the social security benefits currently being paid to existing retirees or pensioners are being financed from tax or social insurance contributions collected from existing workers and taxpayers. Also known as a pay-as-you-go system, it is usually used by governments to fund public-sector retirement schemes.

"Under the system, the problem arises when the number of working people keeps on reducing, relative to the number of elderly people receiving the social assistance," Hamadah says.

Puah Ser Sze, practice leader in investment consulting at Watson Wyatt (Malaysia) Sdn Bhd, says there is no proper allocation for the defined benefit scheme and when the cost of providing social security benefits becomes very high, governments will not be able to afford it and may have to borrow to continue paying the benefits.

"EPF is not vulnerable [to this problem] as it does not 'guarantee' a certain level of benefits. The benefits arise from the members' and their employers' contributions," Puah says.

The risk with a defined contribution scheme lies elsewhere. Hamadah says members may find they have not accumulated enough money to provide them with their desired level of income over their entire lifetime. "If the benefit is not annuitised, they run the risk of outliving their savings," he says.

While the EPF may not have to guarantee benefits, it has an obligation to ensure that members have adequate savings to comfortably retire on. In 2007, it launched the "Beyond Savings" initiative to improve its members' financial security in retirement in the face of changes in Malaysia's socio-economic environment.

"Helping members optimise their retirement prospects and addressing income adequacy issues are high on our agenda and we are constantly reviewing ways to help members save for their old age," says Nik Affendi Jaafar, the EPF's general manager for public relations.

Investment rates

Surely, better dividends would boost one's funds? The question "Why are returns from the EPF's investments lower than those offered by other investment products or tools?" has been asked so often that it is listed in the frequently-asked-question section in the EPF's website. As a long-term fund, with most members not requiring the funds for 20 to 30 years, why are returns closer to that of a short-term fund? Datuk Dr R. Thillainathan, adjunct professor at the faculty of economics and administration, Universiti Malaya, in his paper entitled "Malaysia: Pension & financial market reforms and key issues on governance" remarked that the EPF is and can continue to be under-invested in equities on account of a possible bias towards capital preservation. He suggests, instead,

How retirement funds worldwide operate

A look at some of the largest retirement funding schemes around the globe:

Hong Kong SAR

MPF Hong Kong's Mandatory Provident Fund Schemes Authority (MPFA) acts as a regulator of all retirement schemes in the Special Administrative Region. Under the MPF system, all investments are done by external fund managers. There are currently 39 MPF schemes in the market providing an aggregate of 354 constituent funds. Members can choose, on average, between nine types of funds within an MPF scheme. Each scheme is allowed to have foreign currency exposure of up to 70% of its total assets. Meanwhile, employer-sponsored schemes may only hold up to 10% of their assets in securities of the participating employer or its associates.

Japan

GPIF Japan's Ministry of Health, Labour and Welfare has the Employees' Pension Insurance and National Pension schemes in place to provide for its citizens' retirement needs. In 2006, the ministry established the Government Pension Investment Fund (GPIF) to invest the reserve funds of the two schemes. The GPIF's role is to secure cash income and ensure appropriate liquidity to finance the cost of paying pension benefits under the two schemes. GPIF has been consistently ranked as the world's largest fund since 2002. It invests a portion of domestic bonds on its own while other types of investments are done by external fund managers.

Singapore

CPF The Central Provident Fund (CPF) is the island republic's retirement fund manager. While similar to Malaysia's EPF, contribution rates by CPF members vary with age and are subject to a wage ceiling. The proportion of contributions for housing, retirement and healthcare also varies by age.

CPF members earn a minimum risk-free interest of 2.5%, which is guaranteed by the government. Savings in all three CPF accounts — Special, Medisave and Retirement — were guaranteed a minimum 4% interest for last year and 2009. From May onwards, members have to set aside S$20,000 in their Ordinary Account and S$30,000 in their Special Account before the excess savings can be used for investments.

The UK

BASIC STATE PENSION The defined benefit retirement plan includes a mandatory contribution into the National Insurance (NI) scheme. Payment of enough contribution towards the NI will entitle each member to receive a basic state pension at retirement. The state pension age is currently 65 for men and 60 for women, and will increase gradually to reach 65 by 2020.

PRIVATE RETIREMENT PLANS The retirement assets of British Telecom (BT) make up the largest private retirement fund in the UK. BT currently has two retirement schemes — BT Pension Scheme and BT Retirement Plan. The former is for employees who joined BT before April 2001 while the latter is for those who started working after the date and is a defined contribution arrangement. It requires members to choose from a range of funds to invest in, as well as determine their own risk profile for the trustees to start investing on their behalf.

The US

CALPERS There is no specific sovereign fund in the US. California Public Employees' Retirement System (CalPERS) is the country's largest public pension fund with a US$183 billion investment portfolio. CalPERS is a defined benefit retirement plan, providing benefits based on a member's years of service, age and highest compensation. It administers retirement benefits for more than 1.6 million active and retired state, public school and local public agency employees and their families on behalf of 2,600 California public employers.

401(K) PLAN A 401(k) plan is a representative of a defined contribution scheme in the US. The scheme is normally established by an employer for selected company workers. Employees make contributions towards the plan and the employer may match the amount on behalf of the workers. Some 401(k) plans allow members to direct and manage their own investments. Others have employers hiring professional fund managers to make investment decisions. The scheme, however, is not guaranteed by the US federal government.

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that the fund be marked to market and benchmarked with reference to the performance of the market.

Currently, it is guaranteed by the government to have a minimum 2.5% annual dividend. Hamadah says that the EPF's need to maximise its short-term returns for dividend declaration may not warrant its having a bigger exposure in equities. Stocks are historically very volatile in terms of returns even though they have outperformed many other asset classes over the long run. "We must assess the nature and terms of the EPF's liability in order to appreciate its long-term investment strategy," he says.

Hamadah adds that most occupational pension funds are currently struggling to maintain the values of their assets relative to their expected liabilities, due to the difficult investment climate of the past couple of years. This problem applies to both defined benefit and defined contribution schemes.

He gives the example of how participants in the Hong Kong Mandatory Provident Fund system have seen the value of their investment drop 30% to 50% over the past two years.

Experts say it is a daunting task for the EPF to ensure that its investment strategy continues to work to garner a respectable return for its large and ever-growing membership base.

Last year, the EPF invested over 28% of its funds in Malaysian Government Securities (MGS) and about 25% in equities. The rest of the funds were put in property, bonds and other asset classes. It attained RM20 billion in income, primarily driven by income from investments in loans and bonds (RM6.78 billion), equities (RM6.67 billion) and MGS (RM4.94 billion). Consequently, the EPF posted RM14.31 billion in net earnings for the year and declared a 4.5% dividend for members, after making a provision of RM4.68 billion for diminution in value of equities, as stock prices fell in tandem with the global financial meltdown.

Diversification time

The EPF is, however, running out of options. Besides being one of the oldest, it is also among the world's biggest retirement funds. The fund has said that its size will exceed RM500 billion by 2013. Its participation in equities accounts for about a quarter of its total investment, and any movement it makes, are always scrutinised by other market players. The act of selling a particular stock can trigger a big price movement that may wipe out any profit the fund had hoped to make initially. It is only in the past few years that it has invested abroad, and even then, each investment needs approval from the government.

Watson Wyatt's Puah says the EPF is extremely exposed to the Malaysian economy. "Diversifying investments into non-domestic markets and other asset classes would help diversify the risks away from the Malaysian economy. Some investments have lower volatility than the Malaysian investments and others higher. Hence on an overall basis, introducing these other investment may even lower the volatility of returns of EPF's investments," she says.

However, she notes that diversifying introduces other risks into EPF's portfolio, especially currency risks. These risks will need to be properly monitored and hedged against, where possible.

"Any success, however, comes with proper governance first. The higher the governance, the more likely it is that a fund is able to successfully reap the rewards of diversifying its investments," Puah adds.

Governance, says Puah, refers to the system of decision-making and oversight uses to invest the assets of the fund. It is also a function of organisation coherence, investment expertise and process. "In the context of pension funds, proper adherence to corporate governance minimises the risk of fraud and misappropriation. It also places extra accountability on the part of managers and trustees to manage the funds in a sound and transparent manner," says Hamadah.

Governance and transparency

Hamadah reminds that most of the investment decisions are made by people who are usually not the owner of the capital being invested, and retirement funds normally pass on the investment risk to their members. That is one reason why setting clear guidelines on investment policies is a key element to ensure the success of any pension fund, he adds.

In the EPF's case, it is governed by a board whose members are appointed by the minister of finance. There is an Investment Panel, which has equivalent status to the EPF board. Members are also appointed by the minister of finance.

A report in 2005 indicated that members of the investment panel were not required to report their investment activities, although independence would mean abstaining from voting on any interested party transaction.

A long common critique of the EPF is the questionable investment moves, lack of transparency and weak governance issues. Among suggestions cited by respondents in our poll (see Page 60) include one that exhorts the EPF to "show how its external fund managers have performed", "provide monthly fund fact sheets" and "publish investments online for public scrutiny".

The EPF lists its investments in different asset classes, stocks of companies it holds and names of properties it invests in, in its annual report. But "The EPF's management practices with respect to accounting, performance measurement and dividends declared depart significantly from best practices that apply to a private sector fund manager," says Thillainathan. He highlights that the annual report's equity portfolio is not marked to market.

Australia's Future Fund and New Zealand's Superannuation Fund (NZ Super) are rated by Watson Wyatt as highly transparent. Puah says both funds have their investment structures, including strategy and managers as well as portfolio information, on their websites. The NZ Super, for example, has names of companies it invests in and publishes a performance and portfolio update on a monthly basis. The report includes information on the portfolio's performance, the current asset allocation and significant holdings. ■