

# 18<sup>th</sup> ASSA BOARD MEETING SEMINAR



*Theme*

*Social Security Reforms*

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## **LESSONS FROM ASEAN COUNTRIES**

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*5 September 2006*

*Grand Plaza ParkRoyal Penang  
Malaysia*

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***Lessons from ASEAN countries***

***5th September 2006***

**Zainal Abidin Mohd Kassim, FIA  
18<sup>th</sup> ASSA Board Meeting and Seminar 2006  
Penang, Malaysia**



*Section 1*

***General Observations***





### **Structure of Social Security set up in the ASEAN Region**



- Generally provision for old age retirement, death and disability in employment and health care financing not well integrated.
- Government sector Social Security needs are usually provided for separately from that of the private sector. Usual to have defined benefit pensions for the government sector and lump sum for others.
- The generally large informal sector (self employed) and unemployed (including housewives) are usually not included under the formal Social Security umbrella.
- Mixture of funding arrangements are evident, from funded through direct taxation, employees and employers contribution.

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### **Structure of Social Security set up in the ASEAN Region**



- Defined Benefit arrangements are probably being mainly funded through a Pay as you go arrangements.
- Defined Contribution arrangements generally includes some form of members choice and prior retirement lifecycle withdrawals
- Approach to Social Security provision seem to have developed through reactions to needs as it arises, this has resulted in unintegrated/silo approaches to provision of old age, health care, invalidity and dependents benefit. This can result in overlaps or gaps in benefits and inefficient use of resources.
- Generally underdeveloped private sector third pillar in most countries.

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### *Is there a problem brewing...*



- Current demographic and family structure in most ASEAN countries have shielded governments from having to deal with old age problems currently faced by more developed countries
- Defined Benefit schemes are basically funded on a pay as you go basis and again due to existing demographic structure, has yet to be tested.
- Current health provision structure in many ASEAN countries are geared towards curing/preventing infectious diseases. As changes in lifestyle which comes with modernisation advances, are we prepared to deal with degenerative diseases resulting in prolonged and serious illness?

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### *Section 2*

### ***Asean: A Special Region***



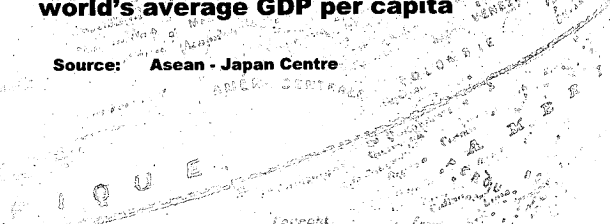


## Overview

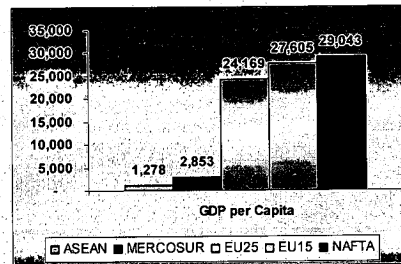
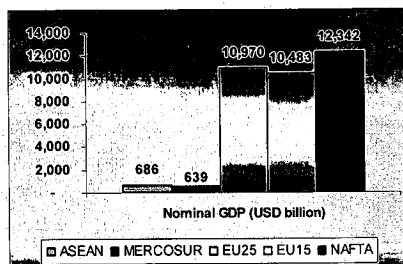


- Covers an areas of 4.48 million km<sup>2</sup>, approximately 3.3% of the total size of the world
- Total population of 537.11 million (data of 2003), approximately 8.6% of the world population
- Nominal GDP of USD686.3 billion, approximately 1.9% of the world GDP
- GDP per capita of USD1,278, approximately 22% of the world's average GDP per capita

Source: Asean - Japan Centre



## ASEAN: A comparison



ASEAN : 10 countries

EU15 : Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, U.K.

EU25 : the above EU15 and Cyprus, Czech, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak, Slovenia

MERCOSUR : Argentina, Brazil, Paraguay, Uruguay

Source: Asean - Japan Centre

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### ASEAN: A diverse Group



	Population (million) 2003	Life Expectancy at Birth (years) 2003	GDP per capita PPP US\$	GDP per capita growth rate 1990-2003	Average annual change in CPI 1990-2003
Brunei	0.4	76.4	19,210	-	-
Cambodia	13.5	56.2	2,078	4.0	4.3
Indonesia	217.4	66.8	3,361	2.0	13.9
Lao PDR	5.7	54.7	1,759	3.7	29.7
Malaysia	24.4	73.2	9,512	3.4	3.1
Myanmar	49.5	60.2	-	5.7	25.9
Philippines	80.2	70.4	4,321	1.2	7.3
Singapore	4.2	78.7	24,481	3.5	1.3
Thailand	63.1	70.0	7,595	2.8	4.1
Viet Nam	82.0	70.5	2,490	5.9	2.8

Source: Human Development Report 2005, United Nations Development Programme

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### ASEAN: A fast growing region



	Annual population growth rate (%)		Medium Age (source : CIA world Factbook)
	1975-2003	2003-15b	
Brunei	2.9	2.0	27.4
Cambodia	2.3	1.9	20.6
Indonesia	1.7	1.1	26.8
Lao, PDR	2.2	2.1	18.9
Malaysia	2.5	1.6	24.1
Myanmar	1.8	0.9	27.0
Philippines	2.3	1.6	22.5
Singapore	2.2	1.1	37.3
Thailand	1.5	0.7	31.9
Viet Nam	1.9	1.2	25.9
United States	1.0	0.9	36.5

Source: Human Development Report 2005, United Nations Development Programme

United Kingdom (% p.a. growth)	1985 - 1990	1990 - 1995	1995 - 2000
	0.3	0.5	0.4

Source: UNECE Statistical Division  
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## ASEAN: Still Growing



Unit of measurement : number of children per women

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Brunei	2.9	3	3	3	2.9	2.8	2.9	2.7	2.7	2.4	2.4	2.2
Cambodia				4.9			5.2		5.3		4	
Indonesia	3.3	3	2.9	2.9	2.8	2.8	2.7	2.6	2.6	2.6	2.5	2.5
Lao, PDR		3.4				5.6		4.9		4.8	4.9	
Malaysia	3.5	3.6	3.5	3.5	3.4	3.4	3.3	3.3	3.1	3.2	3.1	3.1
Myanmar	3.6	3.6	3.6	3.5	3.5	3.5	3.5	3.5	3.4	3.1	3	2.9
Philippines				4.1		3.8	3.7	3.6	3.5	3.5	3.4	3.3
Singapore	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.5	1.5	1.6	1.4
Thailand		2.2				2	2			2	1.9	1.8
Viet Nam				3.3	3.1		2.7			2.3	2.3	2.2

Source: <http://www.aseansec.org/ASEAN-In-Figure-2003/Chapter-1.pdf>

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## Asean's Inc. Financial Indicators



Country	Inflation rate (year-on-year) (%)	Fiscal balance (% of GDP)	Gov Bond Yield <sup>1/</sup> (%)
Brunei Darussalam	1.1	14.6	3.5
Cambodia	Q2 2005	2004	4.68*
	Q3 2005	2004	11.7
Indonesia	8.4	-1.2	
	Q3 2005	2004	7.75*
Lao PDR	6.5	-2.7	Q1 2005
	Q3 2005	2004	4.4
Malaysia	3.4	-4.3	
	Q3 2005	2004	9.5*
Myanmar	57.3	2004	Q2 2005
	Q4 2004	-3.9	9.2
The Philippines	7.1	2004	
	Q3 2005	-1.1	3.5
Singapore	0.5	2004	
	Q3 2005	0.1	5.4
Thailand	5.6	2004	
	Q3 2005	-2.0	9.0
Viet Nam	7.6		

Source: Asean Finance and Macroeconomic Surveillance Unit (FMSU) Database (compiled/computed from data submission and/or websites of Asean Member Countries' national statistical offices, central banks, and other relevant government agencies)

Notes:

<sup>1/</sup>[asianbondsonline.adb.org](http://asianbondsonline.adb.org)

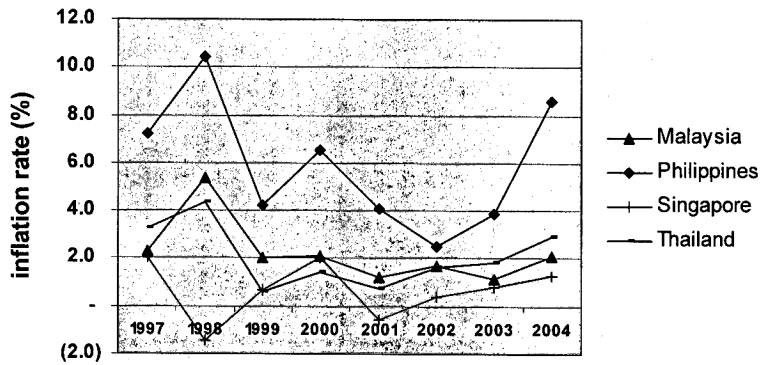
\*Interest rate, 3-month time deposit

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### Asean Inflation Rate



Source: Asean Finance and Macroeconomic Surveillance Unit (FMSU) Database (compiled/computed from data submission and/or websites of Asean Member Countries' national statistical offices, central banks, and other relevant government agencies)

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### Section 3

### Social Security: A preferred approach







## International Best Practice



- The last 30 years have seen a trend away from state monopolistic provision of traditional pensions on a pay-as-you-go basis
- There is a growing recognition today of the importance of a multi pillared pension structure
- Where traditional pensions have been restructured, it is still common to mandate that the basic benefits be paid as an income benefit
- The issue is not only of providing appropriate benefits but the importance of sharing the risk when providing pension, disability income, and other social benefit systems. Such risks are shared between government and the economy, plan sponsor employers and individuals and families

*"The Bank believes that the multi-pillar design is the best solution to pension reform, being much more flexible and better able to address the different risk that pension systems are designed to manage"*

*The World Bank Press Release on Pension Reform 2005*



## International Best Practice

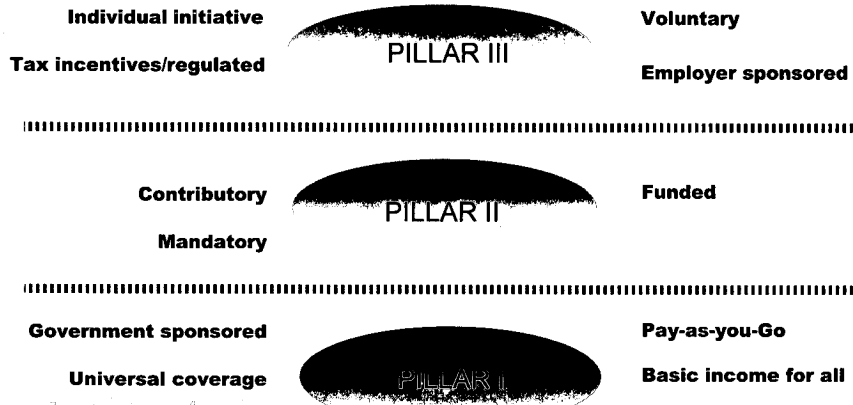


- **Pension and social security system roles in society**
  - protection of the population against poverty in old age
  - protection against financial devastation due to ill health and disability at all ages
  - encourage certain behaviours such as saving, employment mobility and taking individual responsibility
- **Each country places different weights on these factors**
  - The decision should always reflect local realities
  - Ultimately what is feasible depends on how developed and stable the economy is





**The Three Pillars**  
Definition



Section 4

**Retirement Age: When should we retire?**

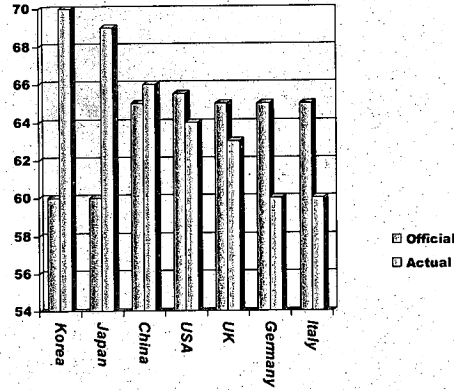




### What is an appropriate retirement age?



- There is formal retirement and actual retirement. Official retirement age is not necessarily the age at which people stop working.
- With increasing life expectancy, a low retirement age means a longer period during which the retiree will have to survive without a regular income from employment. Increasing the retirement age has a dual impact, increasing the period during which the individual can save for his retirement thus increasing the amount saved, and shortening the period for which he needs to live off his retirement savings. This is one solution being used to correct the pension crises in some Western countries.

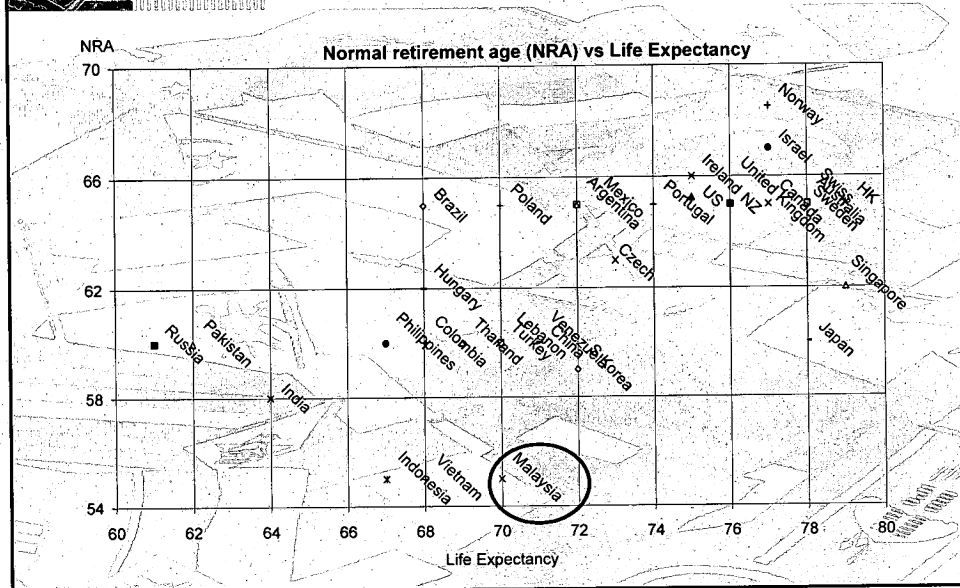


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### Malaysia's Normal Retirement Age Out of line with international practice

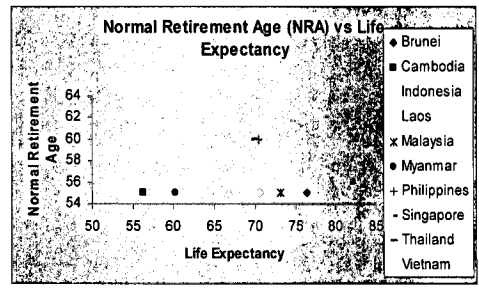




# Normal Retirement Age vs Life Expectancy



Country	Life Expectancy	Normal Retirement Age
Brunei	76.4	55
Cambodia	56.2	55
Indonesia	66.8	55
Lao PDR	54.7	55
Malaysia	73.2	55
Myanmar	60.2	55
Philippines	70.4	60
Singapore	78.7	62
Thailand	70	60
Viet Nam	70.5	55



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## Section 5

### What form should my retirement benefit take?





### **Provision for old age, the Provident Fund Approach**



- Malaysia (the EPF) and Singapore (the CPF) have well established provident funds for employees. These schemes have developed from providing purely for old age retirement to provision of lifecycle benefits.
- The CPF perhaps has a better integrated Social Security offering than the EPF as the latter is only one leg of the country's Social Security blanket.
- It is instructive to review selected experience of the Provident Funds in their quest to provide better benefits for their contributors.



### **The Employees Provident Fund**



- **The amount available at retirement is dependent on the following;**
  - The EPF contribution rate during the period of employment
  - The EPF dividend rate over the period of employment
  - Any amount withdrawn prior to retirement for housing medical etc
- **The average amount withdrawn on retirement at age 55 by recently retired EPF members has been reported to be RM100,000 only.**
- **Comparing with the US, a survey by the Employee Benefit Research Institute reveals that only 21% of household have accumulated more than US\$100,000 in retirement savings while 35% has nothing saved for retirement.**
- **The sufficiency of any amount saved at retirement depends the retirement age, longevity, the retiree's lifestyle and most importantly the interplay between investment income and inflation.**



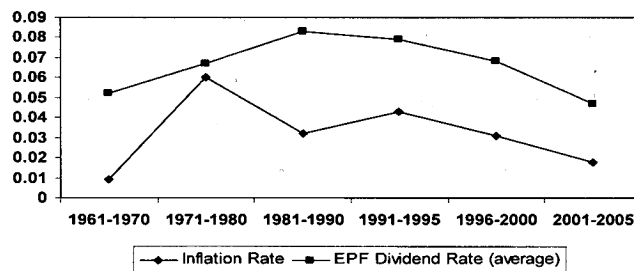
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### Malaysia Inflation vs EPF Dividend



Year	Inflation Rate (%)	EPF Dividend Rate (average) (%)
1961 - 1970	0.9	5.2
1971 - 1980	6.0	6.7
1981 - 1990	3.2	8.3
1991 - 1995	4.3	7.9
1996 - 2000	3.1	6.8
2001 - 2005	1.8	4.7

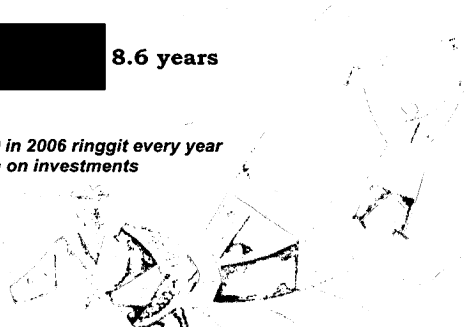


### How long savings will last assuming different inflation rates?



If inflation is (p.a.)	Life span of nest egg is
3%	12.6 years
5%	11.5 years
10%	8.6 years

Assumptions: RM100,000 capital  
 Withdraws RM10,000 in 2006 ringgit every year  
 6% per annum return on investments



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### **EPF Members SPA Scheme**



- Since November 1996, the EPF allows those EPF contributors with more than RM50,000 in their Account 1 to withdraw 20% of the amount in excess of this amount (subject to a minimum RM1,000) and invest this in an approved Unit Trust/ Asset Manager at every 3 months interval. To date in excess of RM8 billion have been withdrawn

As at December 31 2003;

- Offers 25 Unit Trust Companies 178 funds
- Offers 17 Fund Managers
- Covers 136,769 EPF contributors (about 30% of eligible members)

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### **The Choice facing eligible EPF Members**



<b>Keep Savings in the EPF</b>	<b>Members Choice</b>
<b>Collective Risk Sharing</b>	<b>Individual Risk-Taking</b>
<b>Smoothing of Dividend</b>	<b>Volatile Return</b>
<b>Guaranteed Rate 2.5% p.a.</b>	<b>No guarantee</b>



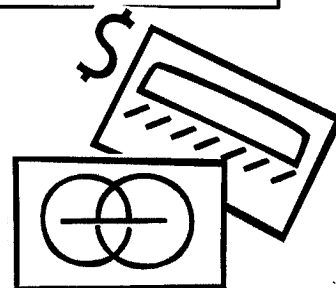
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### Cost of investing in Unit Trusts in Malaysia



	<b>Bid/Offer spread % p.a.</b>	<b>Annual Management Fees % of NAV</b>
<b>Equities</b>	1.65 - 6.2	1.5
<b>Balanced</b>	0 - 6.3	1.5
<b>Bond</b>	0 - 5.3	0.75



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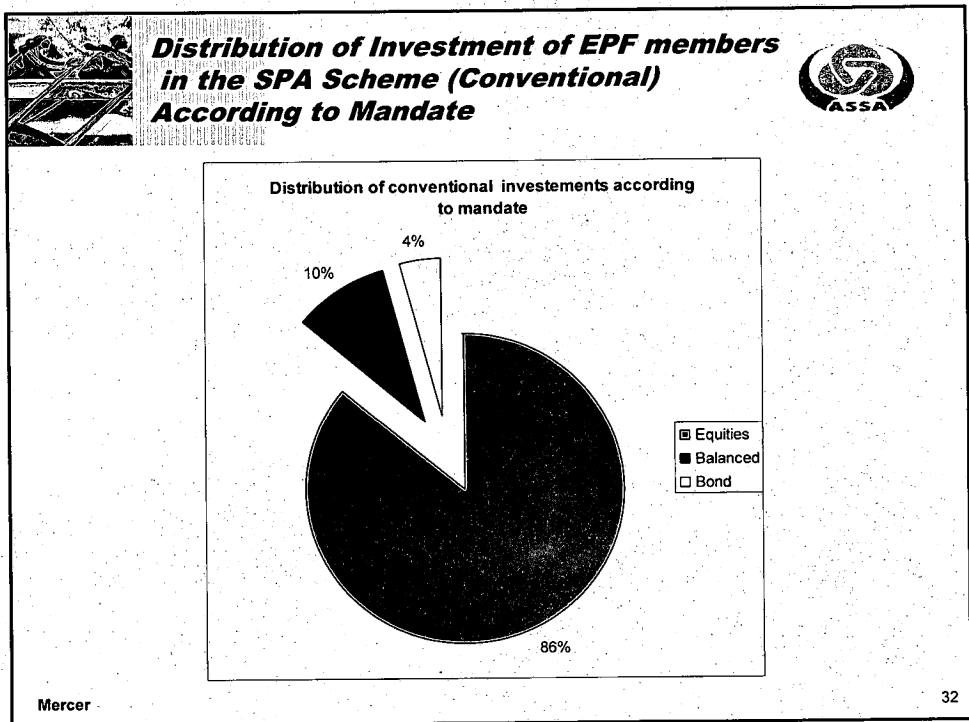
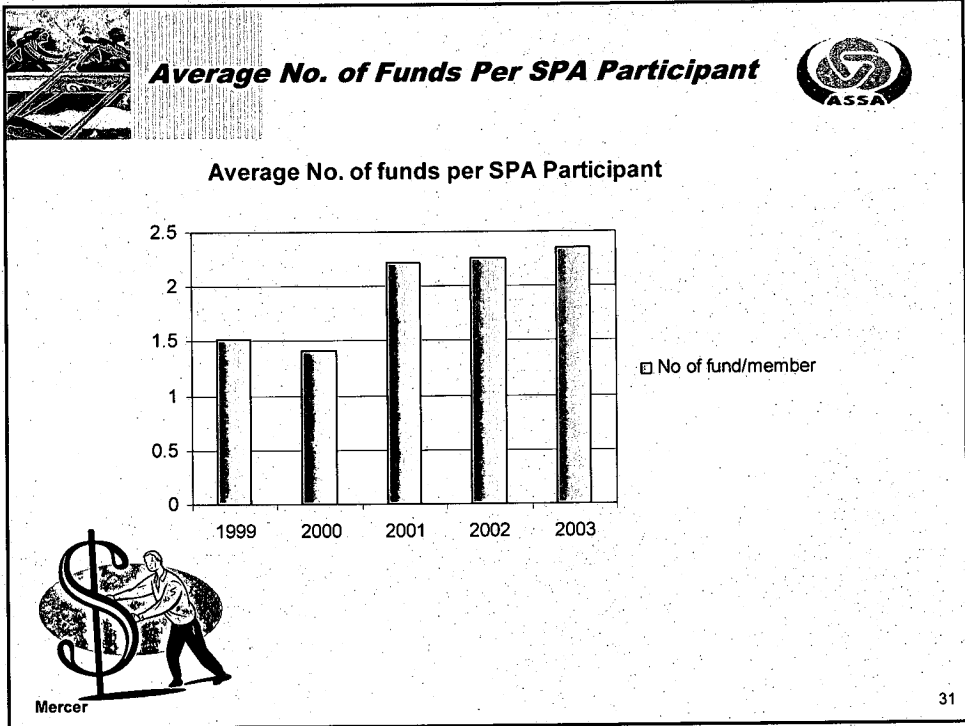
### Profile of Participants under SPA



<b>Male</b>	78%
<b>Female</b>	22%
<b>Average Age</b>	43 years
<b>Average amount per withdrawal</b>	RM9,600

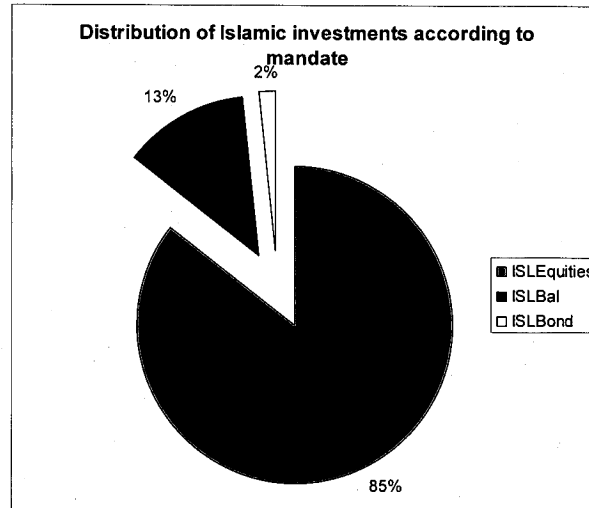
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### **Distribution of Investment of EPF members in the SPA Scheme (Islamic) According to Mandate**



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### **EPF SPA Scheme - The experience to date (Dec 2003)**



- The best performing fund was not the fund with the most amount invested.
- The more successful unit trusts funds (in terms of amount under investment) are those with the more extensive and well organised agency/distribution network. Distribution cost are met from the bid/offer spread and annual management fee.
- The best fund in any category could not maintain their position over all period under observation.
- Current basis of choice of funds mainly dependent on historical investment performance rather than expected future performance.
- Lack of investors education as to how to choose and mix between the various available category of funds (equity, balanced, bonds etc)
- Investors expectation of absolute return has led some funds to stray away from being "true to label".

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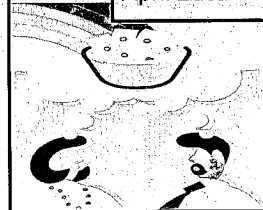
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**One Man's Experience under EPF SPA  
(Dec 2003)  
-Equity Funds**



Investment Date	Rate of Return % p.a.	EPF Dividend % p.a.
April 1997	-1.1	5.7
October 1997	-2.4	5.6
January 1998	6.1	5.5
August 1998	7.4	5.4
March 1999	15.3	5.2
April 2002	-5.9	4.4



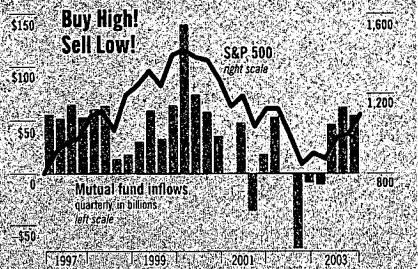
**Do "market aware" investors do better?**



The market is back—oh, the joy of it—and so are investors. But should they be? It's not a shock that the average investor can be less than rational. But whatever happened to the notion of "Buy low, sell high"? The chart at right, which compares net inflows into equity

**by the numbers**

mutual funds with the performance of the S&P 500 over the past seven years demonstrates that investors pile in when the getting is good and flee when stocks are falling. That's precisely the opposite, needless to say, of what they should do. Not only do fund investors react immediately to the gyrations of the S&P, they also often overreact, displaying a volatility normally more associated with, well, the stock market. Buy high, sell low? Poor Benjamin Graham is turning over in his grave. — Matthew Boyle



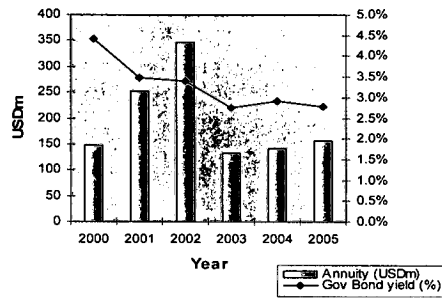


**Singapore Annuity Premium growth vs Interest Rates**



	2000	2001	2002	2003	2004	2005
<b>Annuity (USDm)</b>	148.6	251.5	345.9	132.8	140.2	155.7
<b>Gov Bond Yield (%)</b>	4.4%	3.5%	3.4%	2.8%	2.9%	2.8%

**Singapore: Annuity Premium vs Interest Rates**



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**Section 6**

**Old Age pension comparison**





## What is a sufficient income replacement level?



The answer to this question depends on several factors, among them:

- The level of pay. A low wage earner will have to have a higher income replacement level as he is spending a large proportion of his pay on the basic essentials of life e.g. food and lodging
- The cost of post retirement medical care

In the West, conventional wisdom would indicate that the minimum income replacement level is 2/3rds last drawn salary. The civil servants pension scheme in Malaysia provides an income replacement level of 50% but retired civil servants enjoy free post- retirement medical care for themselves and their spouse.



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## Projected Pension at Retirement Age



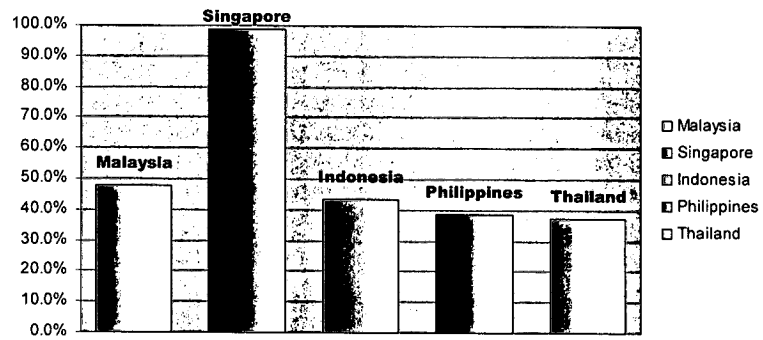
Country	Malaysia		Singapore		Indonesia		Philippines		Thailand	
	EPF	CPF	Jamsostek	additional	private sec additional	Soc Sec Act	Termination Indemnity			
<b>Input</b>										
Pillar	2	2	1							
Age at start	25	25	25	25	25	25	25	25	25	25
Normal Retirement Age	55	62	55	55	60	60	60	60	60	60
Investment return net of expenses	5%	3%	12%	12%	5%	5%	5%	5%	5%	5%
Salary increment	4%	2%	10%	10%	8%	8%	5%	5%	5%	5%
Revalued salary	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
Rate of Pension increase	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
Monthly Salary at start	510	1,306	299	299	263	263	459	459	459	459
Age Rate Up/Down	-	(4)	2	2	1	1	1	1	1	1
Contribution Factor (% of salary)	23.0%	33.0%	5.7%	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>Output</b>										
Projected Salary at Retirement	1,591	2,664	4,738	4,738	4,084	4,084	2,413	2,413	2,413	2,413
Projected Pension at Retirement	759	2,341	728	1,320	597	727	768	136	136	136
Pension as a % of final salary	47.7%	87.9%	15.4%	27.9%	14.6%	17.8%	31.8%	5.6%	5.6%	5.6%

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### Average Replacement income level



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Section 7

**What of Pillar 3?**





### Conditions conducive for Pillar 3



- Pillars 1 and 2 should not “crowd out” Pillar 3. Cover under Pillars 1 and 2 should cover basic “liveable” age pension.
- Pillar 3 is usually tax driven, this could take the form of tax deductible contributions, tax free roll up of investments and tax free benefits at retirement.
- As it is tax driven, there is a need to have an effective Pension Regulator with safety nets in place
- Pillar 3 should be funded, there should be available suitable assets for investments
- Pillar 3 could be driven by the employer or independently by the individual
- Where the individual has control over his investments there will need to be appropriate investor education.

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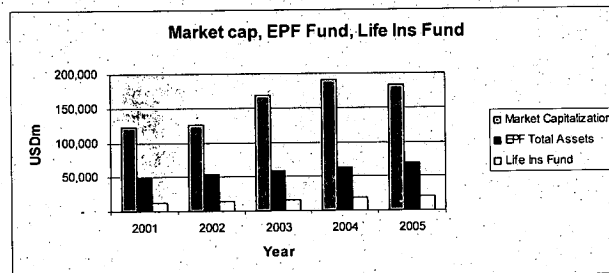


### Malaysian Market



USDm

Year	2001	2002	2003	2004	2005
<b>Equity Market Capitalization</b>	122,268	126,737	168,500	189,842	182,966
<b>EPF Total Assets</b>	49,215	53,204	57,937	63,253	69,423
<b>Life Ins Fund</b>	11,823	13,466	15,841	18,362	20,701



Source: Bursa Malaysia Berhad Annual Report 2004

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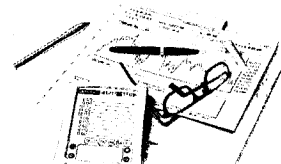
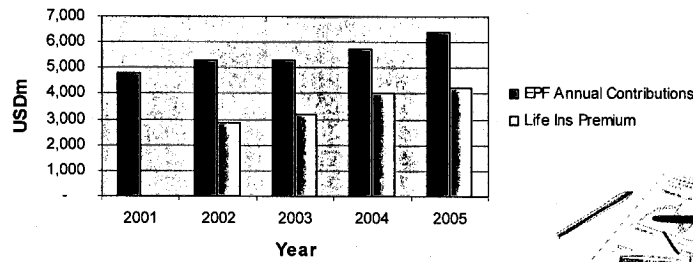


### EPF Contributions vs Life Insurance Premium



Year	USDm				
	2001	2002	2003	2004	2005
EPF Annual Contributions	4,782	5,278	5,301	5,753	6,412
Life Ins Premium	-	2,839	3,203	4,016	4,217

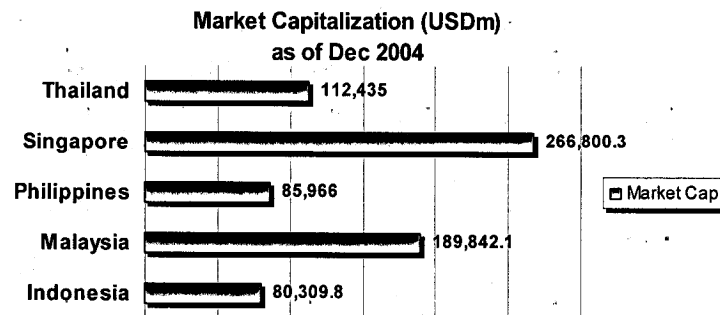
EPF Contributions vs Life Ins Premiums



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### Asean Market Capitalization



Source: Asean Finance and Macroeconomic Surveillance Unit (FMSU) database

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Section 8

***Retirement with dignity, every individual's right.***



### ***Planning a comfortable retirement***



- Determine an appropriate retirement age, 55 is too young to retire. The later the retirement age the longer the accumulation rate and the shorter the divestment term. This means we can save less for retirement.
- Do not forget that you need to protect your savings from the effect of inflation. Invest in some assets which can keep pace with inflation.
- Provide for some expenditure for health care. Study shows that 60% of total health expenditure incurred by an individual is in the last year of life.
- Try to convert your savings to an income stream (an annuity). Life expectancy is still improving. Long life can be a hazardous risk!
- Defend the family structure, this is the fourth Pillar AND ONE THAT HAS BEEN IN EXISTANCE FOR 100s OF YEARS. That could make our retirement "stable" both from the material and social perspective.

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