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EPF's syariah scheme a game-changer

BENCHMARK: An expected migration of some two million members to Simpanan Syariah next year will make it the first and only Syariah-compliant state-run pension fund in the world

BEHIND the euphoria of the announcement last Thursday by the Employees Provident Fund (EPF), Malaysia's iconic pension fund, that it is in the process of launching Simpanan Syariah as an alternative investment choice for its 6.79 million active members, is the depressing global state of the politics and economics of retirement beckoning in the 21st century.

For the future of affordable and dignified ageing for all is as much a challenge for Malaysia as it is for any other country, irrespective of development status.

Datuk Shahril Ridza Ridzuan, EPF chief executive officer, is indeed a pension fund manager on the go. He is keen on matching what his members seem to want with a first-mover advantage, which if successful could prove to be yet another iconic Malaysian innovation in the global Islamic finance space.

The country is supported by the most proactive public policy on Islamic finance anywhere in the world, developed way back from the early 1980s as a dual banking system, where a conventional one operated side by side with an Islamic one — cooperating but not interacting — and what is today called the Malaysian Model.

That was the dream of the then governor of Bank Negara Malaysia (BNM), the late Tan Sri Jaffar Hussein.

Four decades later, Shahril is embarking on an initiative which could eventually have game-changing implications and a renewed relevance for Islamic finance, which has been struggling to establish its identity, especially in a post-2008 financial crisis.

The demand dynamics of Malaysian pension uptake and provision is clear and present. In a survey of EPF members, a staggering 71 per cent of respondents agreed with the launching of a Syariah-compli-

ant retirement offering.

Come Jan 1 next year, on the official launch of Simpanan Syariah, the EPF expects a migration of some two million or 40 per cent of members to the new scheme. The Islamic spoke of the EPF will, at an instant, manage funds in excess of RM120 billion, which would make it the first and only Syariah-compliant state-run pension fund in the world, and the largest to boot.

Shahril comes across as a quiet, self-confident operator at ease with "EPF's vision of becoming a world-class organisation for being the first in the world and offering".

However, it is revealing to know that EPF sees Simpanan Syariah as a

"benchmark for others to follow". For, Malaysians have a reputation in the international market, especially in the Islamic finance space, for being over-modest and non-confrontational.

As such, proven innovations are strictly for home consumption and not to be exported. **Lembaga Tabung Haji**, for instance, one of the top non-bank financial institutions in Muslim countries, if not the world, is a classic example.

Never mind the potential global utility of mobilising the savings of millions of ordinary Muslims, some of whom would never have thought of doing so in the first place, with the added bonus of also merely saving for the annual pilgrimage to Mecca to perform the haj, under the comfort of state patronage instead of ruthless travel operators.

Lest people get carried away, let me put the EPF in perspective. Yes, it is the seventh largest pension fund in the world with assets under management touching RM685 billion, just below Singapore, Canada and China, but way behind Japan's US\$1.14 trillion (RM4.6 trillion), Norway's US\$884 billion and South Korea's US\$430 billion government pension funds.

EPF has enjoyed an annualised investment asset growth rate of 11.5 per cent and a dividend rate of not less than 2.5 per cent over the last three decades. Given the size of the population, and hence, new entrants to the labour market, its relative growth trajectory will be constrained by such demographics.

To put this in a sobering global context, total pension assets last year for the top 19 pension markets, including Malaysia, according to Willis Towers Watson's Global Pension Assets Study 2016, were estimated at US\$35.4 trillion, slightly down on the previous year, albeit pension assets relative to gross domestic product for the above countries declined to 80 per cent last year compared with 84 per cent in the previous year.

Indeed, we hear so often these days about pension black holes and the millennial generation having to work longer to pay for some of the excesses of their fathers and grandfathers. Only recently, British Home Stores went into administration leaving a pension black hole of over half a billion pounds.

Whether it is through poor asset allocation strategies or senior executives raiding their workers' pension fund for nefarious reasons, the point is that pension investments can go belly-up for manifold reasons.

In the case of EPF, while it is heavily invested in Malaysian equities, bonds and *sukuk*, given its size, it has to be more globally focused at the same time. Currently, its overseas investments account for 25 per cent of its portfolio.

"We always felt that for the purposes of protecting the overall return of the fund, we needed a more diversified base. In terms of our assets and portfolio, this strategy has worked out pretty well. Even in the light of the weakening ringgit we have still been expanding overseas.

"We work very closely with BNM,

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especially to mitigate volatility in the spot market, which is the extent of our restrictions in terms of investing overseas. We are still in the process of getting the right mix in terms of the asset base," explains Shahril.

True, EPF has a lot going for itself as a pension fund. It is arguably one of the most proactive when it comes to shareholder activism and has set the benchmark for transparency in its voting record in companies in which it has substantial holdings.

It is also the largest pension investment fund (PIF) investor in the Syariah space — up to 45 per cent of its investment portfolio. With the launch of Simpanan Syariah, this could go up even further. But, a word of caution, though! Is the Islamic finance space capable of absorbing such increased demand, not only from EPF, but also other public investment funds?

"In the Islamic finance space, we need to look into refining the rules and getting more clarity on the rules over the timeline as we develop the space," advises Shahril.

These include greater Syariah clarity in terms of leverage and interest income ratios of listed companies, and access to liquidity.

EPF is fortunate in its *sukuk* investments. The Malaysian market is the largest and most developed in the world with a wide range of maturities and issuers. As such EPF's *sukuk* investment strategy has an importance that goes beyond the return expectation of its members.

The latest figures from the Securities Commission Malaysia for actual *sukuk* issued in Malaysia show a marked 10 per cent year-on-year decrease to RM117.7 billion last year from RM262.76 billion in 2014.

As such, more involvement in *sukuk* issuances by the likes of EPF will give that much-needed traction to the domestic market and restore the dominance of *sukuk* as the preferred choice of fixed income instruments for local and international investors.

Not surprisingly, Shahril is oft mobbed by a beauty parade of flattering fund managers trying to get a chunk of the mandate which EPF inevitably outsources.

At best the PIF involvement in the Islamic finance industry is minimal.

The reality is a mere five per cent migration of the investment of the 26 or so PIFs from the Muslim countries would result in a phenomenal multi-billion dollar incremental increase in the market size of the global Islamic finance industry. However, the investment will, especially of SWFs in GCC countries, tends to be highly prejudicial against investing in *sukuk* and other Islamic finance assets.

However, there is a pension conundrum of potentially seismic proportions, which is beckoning, especially as the inequality gap in wealth and earnings in countries and between countries shows no signs of abating, and what the World Bank has coined as "the greatest threat to humanity".

Over the last few years, the financial inclusion debate has rightly

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Fund focused on educating people on basic level of savings

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championed the plight of billions of people who are "unbanked" — basically people with no access even to the most basic bank account.

That figure, according to the World Bank, stands today at two billion adults.

What the World Bank and other international "do-gooders", together with governments, regulators and PIFs, have failed to champion under financial inclusion are the billions of ordinary working class people who are "unpensioned" — those who have no chance of earning enough to save, let alone pay into a pension scheme.

Shahril concedes that this is a challenge, including in Malaysia.

"What you find is that the bottom half of our population do not earn enough to save enough during their working lives. If you look at any re-

tirement system, whether it is based on defined benefits or defined contributions, you are going to have divergence.

In the defined benefits system, the state can only provide the bare necessities or basic income level or replacement level for its population. This means that most people who want a comfortable living will have to save during their lives."

EPF research shows that the top 30 per cent of working Malaysians (in other words the very rich and rich) can easily afford and plan for their retirement provisions. But, a staggering bottom 40 per cent will not be able to do so, and will depend on state handouts and charity if they cannot muster the savings bottom line.

Over time, this becomes problematic because of inflation, the increasing cost of longevity due to medical costs, increasing contributions and lower benefits. But, perhaps more importantly, it has potentially catastrophic sociopolitical implications of alienation, poverty enhancement, emergence of urban underclass and, yes, radicalisation.

EPF is focused on pension and financial literacy in making people understand the basic level of savings they should aim for to meet certain income levels when they retire. That is fine for people who are earning enough. What about the people who are not?

This feeds into a whole new paradigm for the 21st century society — that of inequality, earnings differentials, wealth distribution and the morality of a minimum, nay, living wage.

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The KWSP building in Jalan Raja Laut, Kuala Lumpur. EPF has to be more globally focused.