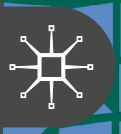

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Pension at Stake

Issues and Solutions to Defined Benefit Pension Scheme in Malaysia

Muhammad Irfan Abdul Rahman
Wee Yeap Lau

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Pension at Stake

"There is a need to reform the defined benefit pension scheme. There will be longevity risk in the long run as the life expectancy of the pensioner increases, coupled with the issue of an ageing society and declining trend of fertility rate among the younger generation. It is important for the pension authority to prepare ahead in order to avoid any shock to the pension scheme. The authors have made a bold attempt to look into this pertinent issue."

—Hooy Chee Wooi, *Professor of Finance, School of Management, Universiti Sains Malaysia, President, Malaysian Finance Association*

"In this insightful examination of Malaysia's pension dynamics, the study becomes a powerful tool for social change, enhanced by the use of robust applied financial econometrics. It digs deep into the core issues, addressing not just financial complexities but the broader societal impact. The research bravely uncovers the flaws in the Malaysian civil service pension plan, offering potential remedies that could reshape the Malaysian welfare state. The study not only transcends numbers but provides a sophisticated understanding of assets and liabilities. An important read that brings attention to the human side of pension sustainability while recommending well-informed policies."

—Amri Rahamat, *Strategic Asset Allocation Professional*

"Embark on a journey into the future of Malaysian pensions with 'Navigating Longevity.' This book does not just offer solutions—it hands you a compass. Feel the critical pulse of pension sustainability for enduring financial resilience and security in the long run."

—Nidaa Ul-Husna Mazlan, *Risk Management Professional*

"*Pension at Stake* offers insightful analysis and viable solutions to the challenges faced by Malaysia's pension system - a must-read for financial professionals and policymakers."

—Ng Swee Kiang, *Head of Investment Education, Equities Tracker Holdings Berhad*

"As we navigate through the complexities of economic policy and financial management, grasping the detailed mechanics of pension systems like Malaysia's becomes not just beneficial but essential. This book does exactly that as it breaks down the multifaceted aspects of pension management, asset allocation and

the looming concerns over long-term viability in a way that is both accessible and deeply informative. This book is a must-read for policymakers, financial professionals and anyone interested in the future of pension systems."

—Royce Tan, *Associate Director, MIDF Research*

Muhammad Irfan Abdul Rahman ·
Wee Yeap Lau

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Muhammad Irfan Abdul Rahman
Faculty of Business and Economics
Universiti Malaya
Lembah Pantai, Kuala Lumpur
Malaysia

Wee Yeap Lau
Faculty of Business and Economics
Universiti Malaya
Lembah Pantai, Kuala Lumpur
Malaysia

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Foreword

Pension funds, particularly for civil servants, have become a burning issue in light of Malaysia's tight fiscal space. In recent years, a raging debate has emerged over the rapidly rising operating expenditure, one that tends to overwhelm development expenditure and pose challenges given the flagging government revenue. Several obvious observations and questions come to mind: is the size of the civil service too large, and should the pension scheme be revised or even removed? Is the fiscal burden of huge pension payouts sustainable, with Malaysia's ageing population and higher longevity?

In 2024, it is expected that about 10.5% or RM32.4 billion of the federal government revenue will have to be used for retirement charges. It is worrisome that while the government expects a revenue of RM307.6 billion, federal government expenditure will be about RM393.8 billion, giving rise to a deficit of RM86.2 billion. It would be simplistic to think that this is the only figure that has to be considered. However, it certainly gives some flavour of the seriousness of the problem.

The existing fiscal situation forces us to draw attention to the existing pension scheme, which, indeed, must be reconsidered in view of the challenges it faces. The increasing longevity of the population and, therefore, of the fund's members pose a risk of its own, and it places pressures on the sustainability of the fund. Not only does the government have a heavier burden before it, but also those managing the fund have to ensure that the returns earned are acceptable. The management of the

pension fund then becomes an issue at the micro-level quite, apart from the macro-pressures that have to be dealt with.

In view of the many questions that have to be answered, the state of pension funds in Malaysia is an important issue that demands attention. This book is a pertinent and timely contribution to the ongoing discussion, and it seriously addresses some of the problems that are troubling policymakers. This attempt is perhaps the first book-length treatment of the topic, with the authors undertaking a detailed empirical analysis based on which they have produced some recommendations. Anyone working on pension funds in Malaysia cannot afford to ignore this book.

Shankaran Nambiar
Head of Research, Malaysian
Institute of Economic Research
(MIER)
Kuala Lumpur, Malaysia

Preface

This book is conceived from a series of work done in the past three years. This book intends to examine a number of issues faced by the civil service pension scheme in Malaysia. As known by the public, the civil service pension scheme is administered by Kumpulan Wang Persaraan (Diperbadankan) (KWAP) or the Retirement Fund (Incorporated) that was established on 1 March 2007 under the Retirement Fund Act 2007 (Act 662), replacing the repealed Pensions Trust Fund Act 1991 (Act 454).

Increasing allocation under the fiscal budget under a decreasing fiscal space makes the issue of the government pension scheme a debatable issue. The Auditor General's Report published on October 10, 2023, revealed that federal liabilities were RM1.399 trillion at the end of 2022.

The federal liability ratio to gross domestic product (GDP) in 2022 was 78.1%, which has decreased as compared to 84.3% in 2021.

Against this backdrop, to quote some figures from the first MADANI 2023 budget, RM 39.5 billion is allocated to pension, retiring allowance, and gratuity, which is 11% more compared to the budget allocated in year 2022e (RM27.5 Billion). This allocation is expected to increase more, mainly due to the rising numbers of retirees, longer life expectancy and the salary increment during the service tenure. The increase in allocation to pensions is alarming, and some measures must be taken to control it.

A summary of the book: Chapter 1 briefly introduces the five pillars of pensions and Malaysia's pension scheme and provides an overview of

the pension system in Malaysia. Chapter 2 examines the determinants of pension cost. It reviews previous literature on pension expenditure and provides some results to support the discussion. This study discusses the sustainability factors of pension obligations through pension-funded ratio, pension asset allocation investment, and pension-required return.

Chapter 3 focuses on the asset allocation in KWAP and how it impacts its return as investment income is one of the primary sources to sustain a pension scheme by KWAP's asset allocation. Chapter 4 reviews the long-term pension-funded status for KWAP in maintaining liabilities for the next ten years.

Chapter 5 intends to explore the required return for the Malaysia Retirement Fund to maintain an individual pension scheme. Scenario analysis has been implied based on four inputs of contribution rate, retirement age, life expectancy, and years of service in civil servants in calculating the required return. The applicability of longevity bonds in the Malaysian Capital Market is examined in Chapter 6.

Finally, the findings from all chapters are summarised in Chapter 7. The conclusion and recommendations for further research were discussed in this chapter. These findings are discussed in the context of implications for improving the defined benefit pension scheme.

Kuala Lumpur, Malaysia

Muhammad Irfan Abdul Rahman
Wee Yeap Lau

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About the Authors

Muhammad Irfan Abdul Rahman is a Fund Manager at the RHB Asset Management Sdn Bhd and previously worked at Bank Simpanan Nasional, Central Bank of Malaysia and Bloomberg LP. He received his Ph.D. in Financial Economics and Master of Applied Statistics from the Faculty of Business and Economics, Universiti Malaya. He also received his bachelor's in Actuarial Science from the University of Nebraska Lincoln, USA.

Wee Yeap Lau is an Associate Professor at the Faculty of Business and Economics, Universiti Malaya, and previously served as Deputy Dean (Postgraduate) and Head of Department (Applied Statistics) of the Faculty of Economics and Administration. He is an Elected Member of the International Statistical Institute and an Executive Committee Member of the Malaysian Economic Association. He was a MEXT Scholar at Osaka University and a Visiting Scholar at the Risk Management Institute, National University of Singapore. He received his Ph.D. and Master in Economics from Osaka University. He also attended an Executive Education Program at Bendheim Center for Finance, Princeton University. He specialises in the economics of finance and investment.

Abbreviations

AFFB	Armed Forces Fund Board
CML	Capital Market Line
DB	Defined Benefit Pension Scheme
DC	Defined Contribution Pension Scheme
EPF	Employment Provident Fund
FBM KLCI	FTSE Bursa Malaysia Kuala Lumpur Composite Index
GNP	Gross National Product
KLCI	Kuala Lumpur Composite Index
KLSE	Kuala Lumpur Stock Exchange
KWAP	Retirement Fund Incorporated
KWSP	Kumpulan Wang Simpanan Pekerja
LTAT	Lembaga Tabung Angkatan Tentera
OPEX	Operating Expenditure
ROI	Return on Investment
RR	Required Rate of Return
SC	Securities Commission
SPV	Special Purpose Vehicle

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