

A AN OVERVIEW

1. At the outset, let me express my sincere appreciation to the organizers and in particular to Mr Michael Pomerleano for his kind invitation to participate in this highly important annual conference on financial markets and development.
2. The subject matter of my commentary is the relationship between the performance and governance of Malaysia's EPF.
3. I was an Investment Panel member of EPF for many years until recently. But I was not a past Chairman (although Michael has billed me as one). Until 1989, the Chairman of the EPF was the permanent Secretary of the Ministry of Finance. From 1989, the retired chief of the Malaysian civil service has been EPF's Chairman.
4. EPF has assets in excess of USD50 billion. Its assets are still growing at about 10% or more p.a.
5. In relative terms, EPF is huge. The ratio of its assets to GDP is over 50%.
6. There is a great concentration of risk in EPF as its funds are managed in-hours almost exclusively.
7. EPF operates both a retirement fund as well as a multi-purpose savings fund. EPF's multi-purpose savings fund caters to the housing, education and health needs of its contributors.
8. EPF's mandated contribution rate is high at 23% of an employee's salary.

9. The contributor can now withdraw up to 40% of his accumulated forced savings for housing, education and health.
10. With the increase in withdrawals and declining returns, there is a shortage of savings to finance a contributor's retirement living.
11. There has therefore been a call for an increase in the contribution rate, or an increase in the retirement age or a restriction in withdrawals.
12. The purpose of a retirement scheme is to smooth one's consumption over one's lifetime. Therefore, there is a strong case for an employee to work beyond his current retirement age of 55 (especially given his life expectancy of 75). There is no merit in increasing the contribution rate or restricting withdrawals.
13. The PF scheme operated by EPF is akin to a DC plan. It is a funded scheme.
14. EPF's asset allocation decisions are also mandated. The law still requires 70% of EPF's funds to be invested in MGS. Investment in domestic equities cannot exceed 25%. Investments in overseas assets are prohibited.
15. Regulations and a shortage of domestic marketable securities does not permit EPF to invest on a portfolio basis. It has been forced to engage in lending. There has also been calls for it to venture into and run businesses.
16. EPF operates the world's oldest PF scheme. By the reckoning of many, it is the best run PF scheme in the developing world. But private sector employees who are actively contributing to EPF's DC plan only account for 52% of Malaysia's labour force.

17. The government also operates a DB plan for its permanent employees. But this accounts for no more than 6.2% of Malaysia's labour force.
18. Therefore, as much as 42% of Malaysia's labour force is not covered by any retirement scheme.
19. At the outset, I had said I will review EPF's performance and its governance.
20. EPF's performance should be assessed in relation to:-
 - its performance as a retirement scheme and
 - its performance in financial terms.
21. EPF's average real returns have exceeded 3% p.a. This is very respectable in the developing world and even by the record of any public sector funds in the developed world.
22. But EPF's performance as a retirement scheme is not satisfactory.
23. EPF's retirement scheme has not adequately addressed a contributor's market or longevity risks – a matter more fully dealt with in my paper.
24. There has also been a failure to run EPF on a portfolio basis and to restrict its exposure to portfolio risk. In fact, there has been a tendency to take unnecessary business or credit risks.
25. There has also been a failure to run EPF in the best interest only of its members.

26. These failures have raised serious governance issues.

27. EPF's management practices with regard to accounting, performance measurement and dividends declared depart from private sector best practices.

28. This has distorted the behavior of EPF's regulator and fiduciaries, caused a serious mismatch in the interests of its regulator, fiduciaries and contributors and therefore has led to EPF's mal-governance.