Asian Provident Funds

Meeting Tomorrow’s Challenges

Presentation by the Global Aging Institute

World Bank Group Webinar
Kuala Lumpur
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The Provident Fund Model

- The report focuses on India’s EPF, Indonesia’s JHT, and Malaysia’s EPF.

- The provident fund model has two key features that make it an attractive choice for emerging markets:
  - Provident fund savings can be harnessed to advance national development objectives.
  - Provident funds can serve a wide range of savings needs beyond the need to save for retirement.

- To be successful, provident funds must strike the right balance between their competing goals. What the right balance is, moreover, will necessarily shift over time as countries develop and their populations age.

**Assets in Billions of U.S. Dollars at the End of 2018 or Most Recent Year Available**

- **Indonesia** (JHT): 19
- **India** (EPF): 91
- **Malaysia** (EPF): 201

<table>
<thead>
<tr>
<th>Country</th>
<th>Assets as a Percent of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>2%</td>
</tr>
<tr>
<td>India</td>
<td>3%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>56%</td>
</tr>
</tbody>
</table>

**Note:** The figure for India is an estimate for the end of March 2018.
**Source:** EPFO, BPJS, EPF, and GAI calculations

**Active Members in Millions at the End of 2018 or Most Recent Year Available**

- **Malaysia** (EPF): 7.4
- **Indonesia** (JHT): 14.6
- **India** (EPF): 41.2

**Note:** Data for Indonesia are for the end of 2017; data for India are an average for 2016-17.
**Source:** EPFO, BPJS, and EPF
Asia at a Crossroads

- Until recently, governments throughout Asia could assume that those workers who reached old age without a pension or personal savings would be supported by their extended families.

- As Asian countries develop and modernize, traditional family support networks for the elderly are coming under increasing stress. Yet in most countries, government and market substitutes are not yet fully developed. The result is growing retirement insecurity.

- The large age waves due to sweep over the region make the need to build more inclusive and more adequate retirement systems all the more urgent.

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Share of Respondents Saying the Family Should, Ideally, Be Mostly Responsible for Providing Income and Personal Care to Retirees

Elderly (Aged 60 & Over), as a Percent of the Population, 1990-2050


Source: UN Population Division (2019)
Investment & Governance
The Dual Objectives of Provident Funds

Economic Development
- Support government lending
- Supply funds for social capital investments
- Facilitate the growth of private-sector capital markets

Retirement Security
- Reduce old-age poverty
- Provide adequate income replacement in retirement
- Maintain economic growth by minimizing the impact of retirement on consumption

Balance should shift over time
Evolution of Investment & Governance

**Economic Development**
- Government debt
- Domestic infrastructure and state-owned enterprises

**Provident Fund Objective**
- Direct placement in corporations and real estate
- Domestic public markets
- International investment
- "Mark-to-market" accounting
- Lifecycle funds
- "Liability-driven" strategy

**Investment Stages**
- Focus on eliminating fraud, graft, and theft
- Focus on eliminating self-dealing and conflicts of interest
- Focus on developing general investment expertise
- Focus on developing specialized investment expertise

**Retirement Security**

**Governance Stages**
India’s EPF: Investment Summary

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>2008</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Debt</td>
<td>43%</td>
<td>79%</td>
</tr>
<tr>
<td>Non-Government Debt</td>
<td>1%</td>
<td>4%</td>
</tr>
<tr>
<td>Deposits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equities</td>
<td>56%</td>
<td></td>
</tr>
<tr>
<td>Real Estate/Infrastructure/Other</td>
<td>9%</td>
<td>9%</td>
</tr>
</tbody>
</table>

Foreign Assets in 2008: 0%
Foreign Assets in 2017: 0%

Reported Return vs. GAI Calculated Return

Reported Return vs. Inflation and 10-Year Bond Yield

Real Rate of Return: 0.8%
Real GDP Per Capita: 5.5%

Note: Asset allocation is as of 5/31/2008 and 12/31/2017; returns are for fiscal years ending 3/31.
Source: EPFO and GAI calculations
Indonesia’s JHT: Investment Summary

**Pie Chart: Asset Allocation**
- **2008**
  - Government Debt: 52%
  - Non-Government Debt: 13%
  - Equities: 34%
  - Real Estate/Infrastructure/Other: 1%
- **2017**
  - Government Debt: 63%
  - Deposits: 9%
  - Non-Government Debt: 27%
  - Real Estate/Infrastructure/Other: 1%

**Graphs: Performance**
- **Reported Return vs. Inflation and 10-Year Bond Yield**
  - Real Rate of Return: 5.0%
  - Real GDP Per Capita: 4.0%
- **Reported Return vs. GAI Calculated Return**

**Note:** Asset allocation is as of 12/31/2008 and 12/31/2017; government debt includes non-government debt; the Reported Return for 2017 is estimated from return amount and cash flow.
**Source:** BPJS and GAI calculations

Foreign Assets in 2008: 0%
Foreign Assets in 2017: 0%
Malaysia’s EPF: Investment Summary

Reported Return vs. Inflation and 10-Year Bond Yield

Real Rate of Return: 3.7%
Real GDP Per Capita: 3.2%

Reported Return vs. GAI Calculated Return

Foreign Assets in 2008: 1%
Foreign Assets in 2018: 27%

Note: Asset allocation is as of 12/31/2008 and 12/31/2018; the GAI Calculated Return includes unrealized gains/losses on equity investments.
Source: EPF and GAI calculations
Performance Relative to Other Investment Funds

Average Annual Real Rate of Return, 2009 to 2018

<table>
<thead>
<tr>
<th>Provident Funds</th>
<th>Pension &amp; Sovereign Wealth Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>India EPF</td>
<td>0.8%</td>
</tr>
<tr>
<td>Indonesia JHT</td>
<td>5.0%</td>
</tr>
<tr>
<td>Malaysia EPF</td>
<td>3.7%</td>
</tr>
<tr>
<td>Korea NPS</td>
<td>3.5%</td>
</tr>
<tr>
<td>Japan GPIF</td>
<td>4.2%</td>
</tr>
<tr>
<td>Chile AFPS</td>
<td>5.5%</td>
</tr>
<tr>
<td>CalPERS</td>
<td>5.7%</td>
</tr>
<tr>
<td>Norway GPFG</td>
<td>6.2%</td>
</tr>
<tr>
<td>Ontario Teachers</td>
<td>8.5%</td>
</tr>
</tbody>
</table>

Note: The ten-year return for India’s EPF refers to the fiscal years beginning 4/1/2008 and ending 3/31/2018. Japan’s GPIF also has a 3/31 fiscal year; in calculating its average return for 2009 to 2018, returns for 4/1/08 – 3/31/18 and 4/1/09 – 3/31/19 were averaged. CALPERS has a 6/30 fiscal year; in calculating its average return for 2009 to 2018, returns for 7/1/08 – 6/30/18 and 7/1/09 – 3/31/19 were averaged. The return for Chile’s AFPs is the simple average of returns for all fund classes.

Performance Relative to Economic Growth

Real Rate of Return vs. Growth Rate in Real GDP Per Capita, 2009 to 2018

<table>
<thead>
<tr>
<th>Provident Funds</th>
<th>Real Return</th>
<th>Real GDP Per Capita</th>
</tr>
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<tr>
<td>India EPF</td>
<td>5.5%</td>
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<td>0.9%</td>
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<tr>
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<td>0.5%</td>
</tr>
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<td>Korea NPS</td>
<td>3.5%</td>
<td>2.6%</td>
</tr>
<tr>
<td>Japan GPIF</td>
<td>4.2%</td>
<td>0.8%</td>
</tr>
<tr>
<td>Chile AFPs</td>
<td>1.9%</td>
<td>1.0%</td>
</tr>
<tr>
<td>CalPERS</td>
<td>1.0%</td>
<td>0.1%</td>
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<td>6.2%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Ontario Teachers</td>
<td>8.5%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

Pension & Sovereign Wealth Funds

<table>
<thead>
<tr>
<th>Return above GDP Per Capita</th>
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<td>India’s EPF</td>
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<td>Ontario Teachers</td>
</tr>
</tbody>
</table>

Note & Source: See slide 10
Benefit Design & Adequacy
The Two Dimensions of Adequacy

- There are two basic dimensions to the adequacy of government retirement systems: their breadth, as measured by the share of the workforce that participates, and their depth, as measured by the share of preretirement income they replace.

- Although low coverage constitutes an enormous policy challenge in emerging markets, it is no more of a challenge for provident funds than for other types of contributory retirement systems.

- The report focuses on the second dimension of benefit adequacy, where the outcomes are more closely related to the design of provident funds themselves.

- The analysis suggests there is cause for concern about the adequacy of benefits in all three countries covered in the report.
Factors Undermining Benefit Adequacy

ACCUMULATION PHASE

- **Low Contribution Rate**
  - *Indonesia*

- **Nonretirement Withdrawals**
  - *India, Indonesia & (to lesser extent) Malaysia*

- **Low Contribution Density**
  - *India, Indonesia & Malaysia*

- **Rapid Wage Growth**
  - *India, Indonesia & (to lesser extent) Malaysia*

PAYOUT PHASE

- **Early Retirement Ages**
  - *India, Indonesia & Malaysia*

- **Lack of Provision for Lifetime Income**
  - *India, Indonesia & Malaysia*

### Standard Contribution Rate

<table>
<thead>
<tr>
<th></th>
<th>Contribution Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia: JHT</td>
<td>5.7%</td>
</tr>
<tr>
<td>India: EPF</td>
<td>15.7%</td>
</tr>
<tr>
<td>Malaysia: EPF</td>
<td>24.0%</td>
</tr>
</tbody>
</table>

### Preretirement Withdrawals as a Percent of Total Withdrawals in 2018 or Most Recent Year Available

<table>
<thead>
<tr>
<th></th>
<th>Preretirement Withdrawals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia: EPF</td>
<td>42%</td>
</tr>
<tr>
<td>Indonesia: JHT</td>
<td>88%</td>
</tr>
</tbody>
</table>

### Active Members as a Percent of Total Members in 2018 or Most Recent Year Available

<table>
<thead>
<tr>
<th></th>
<th>Active Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>India: EPF</td>
<td>49%</td>
</tr>
<tr>
<td>Indonesia: JHT</td>
<td>52%</td>
</tr>
<tr>
<td>Malaysia: EPF</td>
<td>21%</td>
</tr>
</tbody>
</table>

**Note:** Data for Indonesia are for the end of 2017; data for India are an average for 2016-17. In Indonesia, active members refer to JHT members; total members refer to BPJS members, excluding Jakon workers.

**Source:** EPFO, BPJS, EPF, and GAI calculations
Adequacy Today

- **MALAYSIA**: Nearly three-quarters of EPF members nearing retirement age have saved less than the Basic Savings Amount, a sum intended to finance a poverty-level benefit equal to about two-fifths of the median wage.

- **INDONESIA**: The average JHT lump sum retirement payout is equal to just one and-one half times the average annual wage, which is not enough to finance an inflation-adjusted annuity equal to 10 percent of preretirement wages.

- **INDIA**: GAI estimates that the average EPF balance at retirement is equal to just one-half of the average annual wage, which is not enough to finance an inflation-adjusted annuity equal to 5 percent of preretirement wages.

### Malaysia’s EPF: Percent Distribution of Members and Savings at Age 54 at the End of 2018, by Size of Account Balance

- **Basic Savings Amount in 2018 = RM 240,000**
- **Members**:
  - Under RM 250,000: 72%
  - RM 250,000 - 500,000: 31%
  - Over RM 500,000: 10%
- **Savings**:
  - Under RM 250,000: 17%
  - RM 250,000 - 500,000: 26%
  - Over RM 500,000: 43%

*Source: EPF and GAI calculations*
Adequacy Tomorrow

INDIA
Gross Replacement Rates for EPF Members Entering the Workforce in 2020

<table>
<thead>
<tr>
<th>What happens if...</th>
<th>EPS</th>
<th>EPF</th>
<th>83%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Wage Growth is 2.5%</td>
<td>43%</td>
<td>40%</td>
<td>74%</td>
</tr>
<tr>
<td>... and Contribution Density is 75%</td>
<td>32%</td>
<td>25%</td>
<td>57%</td>
</tr>
<tr>
<td>...and Savings Leakage is 25%</td>
<td>32%</td>
<td>19%</td>
<td>51%</td>
</tr>
</tbody>
</table>

Source: GAI calculations

MALAYSIA
Gross Replacement Rates for EPF Members Entering the Workforce in 2020

<table>
<thead>
<tr>
<th>What happens if...</th>
<th>55%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Wage Growth is 2.5%</td>
<td>44%</td>
</tr>
<tr>
<td>... and Contribution Density is 75%</td>
<td>34%</td>
</tr>
<tr>
<td>...and Savings Leakage is 25%</td>
<td>26%</td>
</tr>
</tbody>
</table>

Source: GAI calculations

INDONESIA
Gross Replacement Rates for JHT Members Entering the Workforce in 2020

<table>
<thead>
<tr>
<th>What happens if...</th>
<th>JP</th>
<th>JHT</th>
<th>60%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Wage Growth is 2.5%</td>
<td>28%</td>
<td>19%</td>
<td>46%</td>
</tr>
<tr>
<td>... and Contribution Density is 75%</td>
<td>21%</td>
<td>14%</td>
<td>35%</td>
</tr>
<tr>
<td>...and Savings Leakage is 25%</td>
<td>21%</td>
<td>11%</td>
<td>31%</td>
</tr>
</tbody>
</table>

Source: GAI calculations

Note: Projections refer to workers who enter the workforce at age 20 in 2020 and retire at the standard retirement age in each country. Account balances are converted into inflation-adjusted annuities using unisex life tables. All scenarios assume a 3.0% real rate of return and a 2.0% real discount rate. The GAI Projection with OECD Assumptions assumes 1.25% real wage growth, 100% contribution density, and 100% savings preservation.
Directions for Reform
Investment & Governance

- Develop explicit guidelines for balancing national economic development and retirement security objectives.
- Continue to diversify investment portfolios.
- Consider moving toward market-linked returns.
- Consider moving toward individual customization of the asset portfolio.
- Enhance the clarity and transparency of financial reporting.
- Better educate members about the importance of retirement savings.
Benefit Design & Adequacy

- Increase savings dedicated to retirement.
- Raise standard retirement ages.
- Institute provisions for lifetime income.
- Explore ways to increase coverage and contribution density.
- Strengthen the old-age safety net.