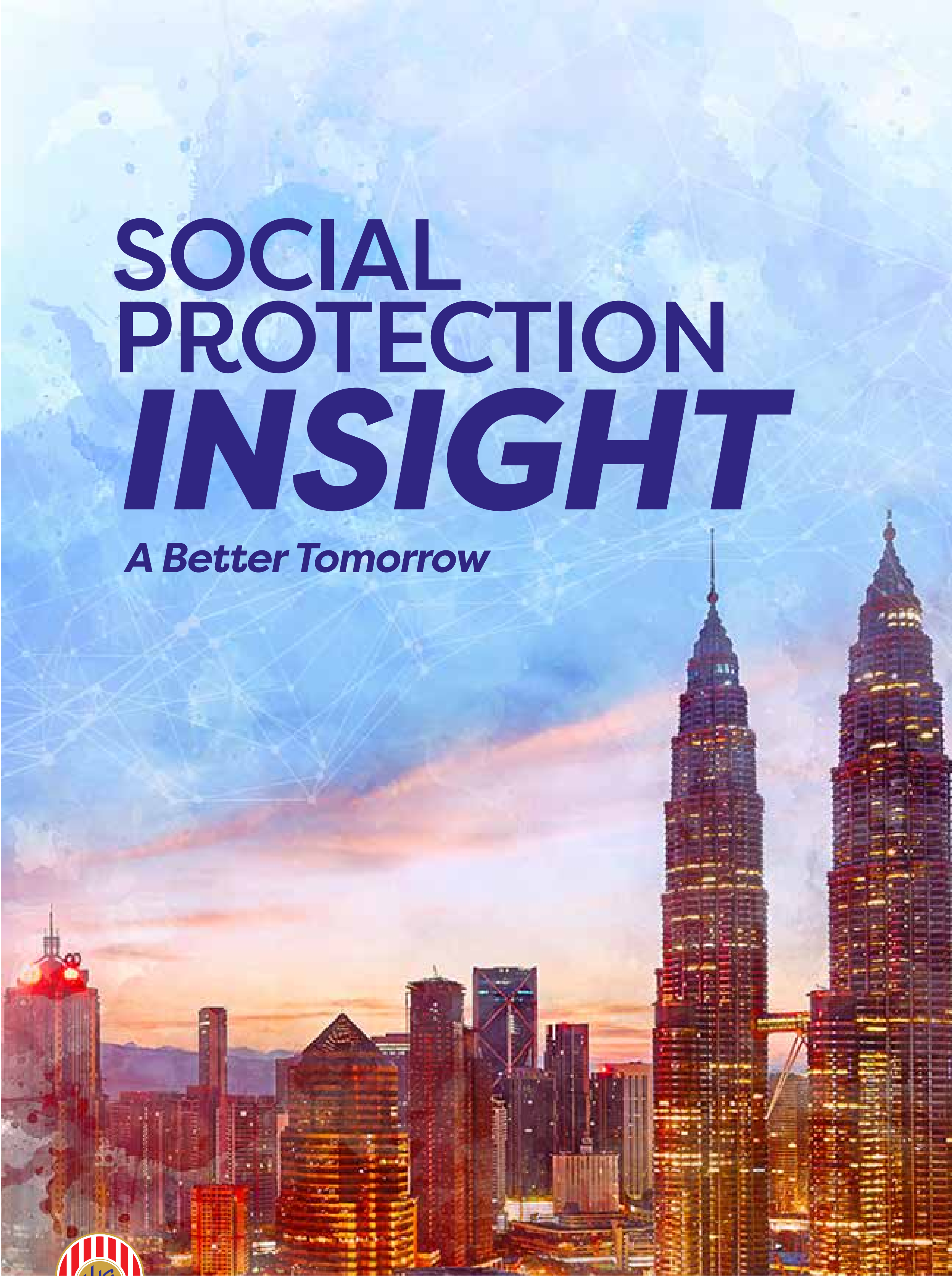
SOCIAL PROTECTION *INSIGHT*

A Better Tomorrow



KWSP | EPF

Vol.3 | 2018

Finding work that suits us plays an important role in our social well-being. And remaining active has been proven to result in greater personal happiness and a longer, healthier life.

EDITORIAL COMMITEE

CONTENTS

RETIREMENT:
THE TIMES THEY ARE A-CHANGING

Harry Smorenberg
CEO. Smorenberg Corporate Consultancy
Independant Strategist

What's Your Retirement Outlook?

In February next year I'm going to be 64. But that doesn't mean I can retire. According to the actuarial tables used in the Netherlands, where I live, I can't start drawing my pension until I'm 68! We're all living longer. And so it'll be another four years before my state pension kicks in. This is the first of the three pillars on which the Dutch pension system is based. As well as the state pension, employees in the Netherlands normally contribute to compulsory occupational pension schemes ('second pillar').

Image source: *Google*

And then there's the third pillar, comprising the savings and other assets people build up during their lives. My sons are now 23 and 27. Looking at the direction the mortality tables are moving in, my younger son won't get a pension until he's 76. And that's presuming pensions in their current form still exist!

The Times They Are A-Changing

More and more businesses are now closing their pension schemes, at least to new entrants. They see these schemes as too high-risk and are keen to leave it up to individuals themselves to provide for their old age. And governments are no different. Slowly but surely, responsibility for financial continuity and for managing the associated risks is shifting to the individual. But are we ready to take on this responsibility?

All too often I see self-employed people who haven't set aside enough for later. To assure yourself of a basic, 'no-frills' pension you should be reserving the equivalent of at least one day's earnings for every five days you work. And that's simply not happening. Something else I see all too frequently is people drawing down their pensions before or immediately after their official retirement date.

Sometimes they're doing this to pay their children's college or university fees. But other times people ask for their pensions to be paid out as a lump sum. That suddenly makes them feel wealthy. But the pleasure they get from the yacht, the luxury vacation or the high-tech TV set is soon forgotten. And all that's left to them then is a long period of relative poverty, where they often have to supplement their income with low-paid jobs in the gig economy until well into old age.

The key word, therefore, is discipline. But that's something many people find hard to put into practice. We're surrounded by temptation. But it's no good waiting till you're 60 to start trying to fill gaps in your pension provisions.

That's why I favor a more paternalistic approach. And that means having the discipline needed to build up a good pension paying out benefits over time and when they are needed. Mercer's Global Pension Index consistently shows the Netherlands and Denmark to have either the best or second-best pension systems in the world. The secret of these countries' success is their willingness to start building up sufficient long-term savings in good time, combined with accepting the need for some solidarity between generations. On top of that, they protect pension savings sufficiently transparently and with various checks and balances in place.

Of course we all want to be secure and have more and more control over our finances. And there's certainly room for improvements on both the information and communication sides.

To me, however, the best way to maximize protection is for individuals to be able to join good, compulsory group pension schemes.

That way, the risk of poor investment decisions and market fluctuations can be spread over the group as a whole, rather than people's pensions being treated like gambling chips at a casino.

Nevertheless, our pensions also need to move with the times.

Living longer means working longer. So we also need our pension schemes to allow more scope for flexible retirement.

While some people want to retire at 55, others are happy to carry on working till they're 72. Employers, too, can play a more active role in helping us extend our working lives. Appropriately-timed retraining and opportunities for sideways or other moves can all contribute to long, healthy and varied careers. Finding work that suits us plays an important role in our social well-being. And remaining active has been proved to result in greater personal happiness and a longer, healthier life.

But that also means accepting our incomes are going to fluctuate more than in the past. And that we're going to have to manage our personal budgets and improve our financial planning. Pension funds and financial service providers face major challenges in correctly aggregating all the information and actively showing us both our current financial position and what the future holds for us. But by helping us in this way, they will encourage us to take control of own financial future.

Harry Smorenberg is the CEO of Smorenberg Corporate Consultancy, founder of the World Pension Summit and the founder and chairman of the European & Global Payment Summits. As a financial services marketing and positioning strategist, he previously worked for several financial institutions and was a director of two leading strategic consultant firms. He is an advisory and excecutive board member at various national and international financial services organizations and universities. (harry@smorenberg.nl)

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AGEING AND RETIREMENT:
PERCEPTIONS AND EXPECTATIONS AMONG MALAYSIANS

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As a result of declining fertility and increasing life expectancy, Malaysia is currently experiencing a steady increase in the proportion of older people relative to the total population. The number of Malaysians aged 60 years and above is projected to reach 3.5 million in 2020 and 6.3 million in 2040, which is about 20% of total population. A report by the Department of Statistics Malaysia (DOSM), shows that a male aged 65 could expect to live to age 80 years, and a female is expected to live to age 82 years.

However, what is the psyche of Malaysians with regards to life expectancy? How long do they think they are going to live? Ageing can entail multiple losses, including loss of work and physical functioning. How prepared are we in meeting our health and financial obligations in later life? Greater life expectancy means individuals must either delay his/her retirement and work more years, save more while working, and have lower consumption in retirement.

A Genworth survey on Americans (2010) found that Americans would ideally like to live up to 92 years old. Our Social Security Research Centre (SSRC) conducted a survey to gain insights into the psyche of Malaysians, targeting males and females aged 40 years and above. Of 518 Malaysians who responded to the survey, almost all indicated that they would like to live to at least 80 years. Yet, many are not self-assured financially

"The majority of those who feel certain about having a comfortable life post-retirement are professionals, whereas non-professionals are less assured."

about having a comfortable life throughout their retirement years. Only slightly half of those surveyed are confident of having a comfortable life, while the rest are not very optimistic. The majority of those who feel certain about having a comfortable life post-retirement are professionals, whereas non-professionals are less assured.

Seventy percent of those surveyed said they would expect to live between 6 to 20 years more after attaining the age of 60, and will continue working as long as their mental and physical capabilities permit and that there should not be mandatory retirement. Working until older ages is one of the most efficient methods for many individuals to finance increased number of years in retirement. Thus, one can expect that many individuals will have a preference for working until older.

In preparation for post retirement, respondents have indicated their plans to boost their savings by reducing current expenses and reducing their cost of living in retirement. A quarter of the respondents intend to move to cheaper locations, while others would turn to family members for assistance or consider living in an assisted facility such as a retirement village, while a good number of respondents said they would turn to the government for old age support.

Governments, however, face funding challenges in supporting retirement programs. In a recent development, our government foresees expenditure on retirees to surge to RM100 billion by 2050 due to longer life expectancy and a surge in the number of civil service retirees whose pensions are not contributory.

Currently only 80 percent of the total 13.5 million labour force in Malaysia have some form of retirement savings or government pension, although government pensions are not contributory. Perhaps the government should review the public pension scheme as a contributory one would provide protection for all Malaysians.

Rising expenditures on pension payments would put a strain on the government's fiscal position. While at the same time, a declining birth rate and longer life expectancy could have a huge impact on the country's competitiveness and productivity level and the cost of healthcare.

It is indeed a tricky balancing act with wide implications on public policy which includes social security, healthcare insurance, expenditures, and taxes. Thus the issue requires concerted effort by both the public and private sectors.

Countries including Singapore, Japan, Canada, Australia, and the United Kingdom have introduced various subsidy programmes to incentivize employers to hire older workers such as special employment credits, federal-state cost-shared programmes and wage subsidies for older workers seeking a return to the job market.

Since financial issues are an important reason for retirees to return to the labour market, employers should consider offering either full-time or part-time "bridge jobs" as an extension of current work to help ease a worker's transition into retirement.

In Singapore for example, the Special Employment Credit (SEC) was introduced in 2011 to support employers and to raise the employability of older Singaporeans workers and persons with disability. The SEC provides a wage-offset to employers hiring Singaporean workers aged 55 and above.

Although the retirement age in Singapore is 62, workers can opt to retire or continue working until the re-employment age ceiling of 67. In Australia, Wage Subsidies for Matured Age Job Seekers (RESTART) employers can receive up to $10,000 depending on eligibility for a full time employee. In Japan where 25 percent of the population are over the age of 65, and people in this age category are expected to rise to 40 percent in 2060, the Japanese government provides various subsidy programmes under the "Law for Employment Stabilization for Older People" to employers who either continue employment of existing older workers or who hire older persons.

Going forward, there can be no doubt that the Malaysian workforce of the future will be older than it is today, and organisations need to think now about how they deal with that change in a way that is appropriate for the industries they are in and the occupations they employ.

Although not all of the answers can be found in the existing research, there are certainly a number of issues that arise from studies, academic or otherwise, that can help organisations start to think more strategically about the role of their older employees.

Workers too have to be willing to continually upgrade their skills and undergo retraining. Post retirement jobs may entail a different nature of work, which one may even find interesting. On the issue of employing people post-retirement, there are labour matters involved and the Centre is working on a blueprint for ageing and how to prepare for it in Malaysia. A deeper understanding of the issues entails developing human resource systems that are appropriate for an age-diverse workforce as the number of older workers grow.

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TOWARDS BETTER RETIREMENT WELL-BEING

Ng Say Fen
Employees Provident Fund

The 21st century saw a breath-taking phenomenon in the form of a growing elderly group attributed to longer life expectancy.

Longevity offers a new set of possibilities for people to enjoy life and relationships. Notwithstanding the benefits, there are far-reaching implications of ageing. Are we, as a generation, prepared to face this phenomenon? Are we able to finance our financial needs for this prolonged journey?

Savings Inadequacy

In the case of Malaysia, the country is forecasted to become an aged nation by 2030 when more than 14% of its population comprises the elderly (aged 60 years and above). This phenomenon, driven by longer life expectancy and declining fertility rates, will have a profound socioeconomic impacts on the nation. A growing elderly population entails a higher old age dependency ratio relative to the working population, putting pressure on fiscal and private expenditure specifically to support the elderly and healthcare costs associated with ageing.

From the individual perspective, a longer life expectancy means a longer retirement period and more savings needed to support post retirement life. However, more than half of the Malaysian adult population are not covered by any retirement or pension system, posing great challenges in fulfilling individuals' financial needs for retirement. Even those who are covered by social protection programmes will face the issue of savings inadequacy as two out of three EPF active members are projected to fail to meet the threshold amount equivalent to a minimum pension of RM1,000 per month to support an active post retirement life.

In preparing to manage such a situation individuals need to make informed financial decisions, requiring a level of financial literacy that many do not have. This is evidenced by the result of the S&P Global Financial Literacy Survey where Malaysia's financial literacy level only stood at 36%.

The situation could be further aggravated by the fact that advancements in digital technologies are rapidly changing the nature of work and the employment landscape which shall see jobs losses in certain sectors, resulting in an increase in the unemployment rate. This will affect income adequacy and the quality of life, not only for these individuals but also their families.

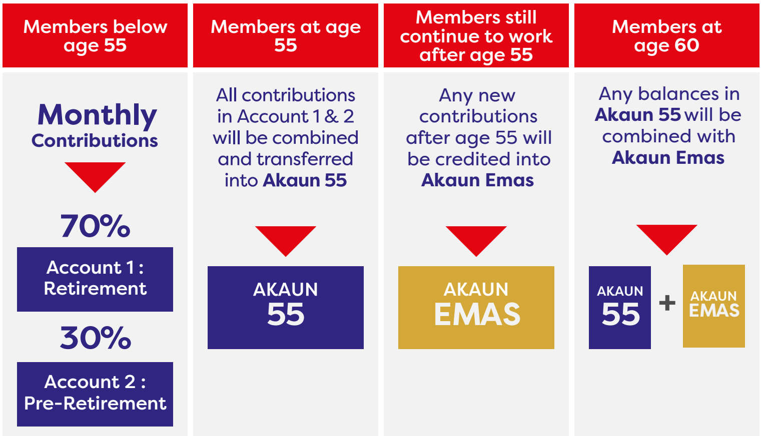
Second Retirement Nest Egg

Recognising the challenges and developments in the operating environment, the EPF introduced a series of initiatives to strengthen its scheme to ensure the well-being of its approximately 14 million members. These enhancements take cognizance of the implications of demographic shifts towards an ageing population, coupled with longer life expectancy, and is aimed at addressing EPF members' savings inadequacy.

In response to the implementation of a minimum retirement age at 60 in Malaysia, the EPF introduced a second retirement nest egg namely Akaun Emas to secure members' contributions after age 55 up to 60. Diagram 1 below explains the EPF account structure.

Image source: *Google*

DIAGRAM 1 : EPF ACCOUNT STRUCTURE



Effective January 2017, all new contributions received from members aged 55 and above will be automatically assigned to Akaun Emas and can only be withdrawn at age 60. The extra savings accumulated during this five-year period are aimed at providing additional financial support in serving members' retirement needs. This will assist in strengthening the savings adequacy during retirement (Refer to Diagram 2)

DIAGRAM 2: ILLUSTRATION ON HOW AKAUN EMAS COULD ADD VALUE TO RETIREMENT SAVINGS

Assumptions: Average life expectancy at age 75; total savings of RM240,000 at age 55; Still enjoy salary increment from age 55-59

The introduction of Akaun Emas will not affect existing withdrawal eligibilities. Members will still have the option to make full or partial withdrawals upon reaching age 55 under the Akaun 55. Members will also continue to earn dividends for their savings in both Akaun Emas and the balance of their savings in Akaun 55.

Flexible Withdrawal Options

The EPF currently offers its members various choices of flexible options to best meet their financial needs upon reaching age 55 and age 60. Firstly, members reaching age 55 and 60 respectively can opt to make partial withdrawals of any amount at any time, instead of withdrawing all of their savings via the lump sum option. Secondly, members can also plan for their withdrawal through the monthly option from as low as RM100 per month. Thirdly, members can opt to withdraw only annual dividends only from their EPF account (Refer Diagram 3).

Such options provide members with choices to plan and manage their savings as they have the flexibility to choose the withdrawal amount and frequency. Through flexible options, members can continue to keep their savings with the EPF to earn annual dividends up to 100 years old. This helps to stretch their savings for a longer period and enjoy the benefits of the compounding effect on their EPF savings. In the long term, members can enjoy greater flexibility in their financial planning, catering for their retirement needs.

DIAGRAM 3: FLEXIBLE WITHDRAWAL OPTIONS (AT AGE 55 AND 60)

Lump Sump	Annual Dividend Withdrawal	Partial Withdrawal	Monthly Withdrawal
Members can withdraw the total amount of their savings	Members can choose to withdraw only the amount of the annual dividend	Members can partially withdraw any amount anytime from their total savings	Members can opt to receive monthly payment from their savings

Flexible options which allow members' savings to continue earning dividends up to 100 years old

Multi-Channels To Increase Members' Savings

Before reaching age 55 and 60 respectively, members can opt to increase their savings throughout their working life via the following channels:

CONTRIBUTE MORE THAN THE STATUTORY RATE

In order to increase EPF savings for retirement, both employees and employers can opt to contribute at a rate exceeding the statutory rates.

ADDITIONAL VOLUNTARY CONTRIBUTIONS

Apart from the monthly contributions submitted through employers, members can increase their EPF savings through voluntary contributions, up to RM60,000 a year.

TOP-UP SAVINGS CONTRIBUTION

The Top-Up Savings contribution offers members the opportunity to increase EPF savings for their loved ones. Members can contribute any amount anytime to the Account 1 of their parents, spouse as well as sons or daughters.

Note: For voluntary contributions and top up savings, the maximum amount is capped at RM60,000 per year

Retirement Advisory Service (RAS)

While the EPF is continuously exploring ways to enhance members' retirement well-being, members are also encouraged to take charge of their retirement planning through the Retirement Advisory Service (RAS) which was introduced in 2014.

RAS is a first of its kind service which offers impartial advice and free advisory services to our members. It serves as a platform for members to obtain personalised advisory from EPF's trained officers in the area of basic financial and retirement planning, aimed to achieve the following objectives:

- Increase awareness and knowledge on the importance of retirement and financial planning;
- Provide financial guidance and advice to members on the options to manage their retirement savings; and
- Addressing issues related to inadequacy or leakages of members retirement savings.

DIAGRAM 4: KEY FEATURES OF RAS

VALUE PROPOSITION	SUPPORTED BY
One-on-One Financial and retirement planning services	**52** RAS officers
Free and impartial Guidance and advice	**28** Branches
Better understand EPF options that suit retirement needs	**6** RAS Outreach Teams

With this service, the EPF has stepped beyond the traditional role of managing investments and related transactional services, towards advisory-focused services. Financial literacy addresses the root cause of the issues and helps members in planning and encouraging savings, ultimately empowering members to make informed financial decisions. The EPF opines that providing our members with basic financial knowledge and holistic information on financial and retirement planning through RAS will lead towards better retirement well-being for our members. To date, close to 100,000 members have visited RAS with a satisfaction rating of 98%.

Moving Forward

To keep abreast with the changing demographics, particularly the ageing phenomenon, coupled with challenges propagated by savings inadequacy due to longer life expectancy and a changing work landscape, the EPF will be embarking on an exercise to refresh the scheme to ensure that the product and service offerings continue to be relevant with the latest developments and to cater for demands based on lifecycle needs. Such an exercise will be guided by its new vision of helping its members achieve a better future, which encompasses financial security and health, leading to a happy and meaningful life.

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KWSP EPF

THE SITUATION TODAY

Not enough retirement savings

68% active members do not achieve basic savings

2 in 3 will live with less than RM950 per month until 75!

70% active members aged 54 have less than RM50k

7 in 10 will live with RM210 per month until 75, or deplete their savings in less than 2 years!

LOW
- SALARIES
- SAVINGS
- FINANCIAL LITERACY

HIGH
- COST OF LIV
- SPENDING PATTERN

RESULTING ⬆ DEBT

80% of Malaysians earn below RM4,000

1 in 3 Malaysians do not have a banking account

RM2,700 Income required by a single adult in urban areas for basics requirements

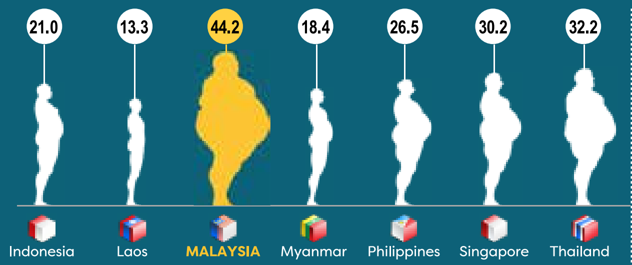
146% Malaysia's household debt to household income, higher than US levels.

On average, for every RM1 earned, Malaysia owe RM1.46

Source: UNDP Malaysia Human Development Report 2013; BNM; McKinsey Global Institute Report

KWSP EPF

Burgeoning Health Issues *due to unhealthy living*

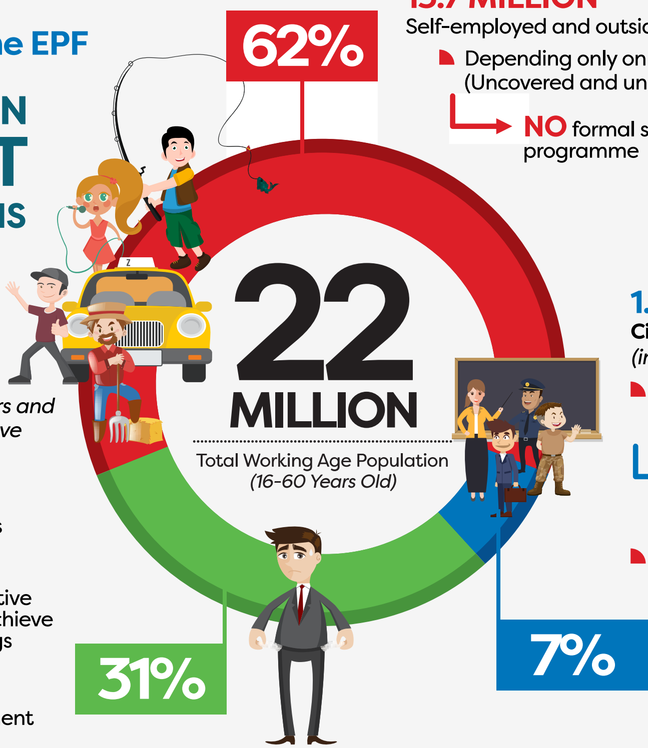


Source: WHO Non-Communicable Diseases Country Profiles, 2011

6 in 10 | Malaysians face non-communicable disease (NCD)

- **1 IN 5** diabetes
- **1 IN 2** physically inactive
- **1 IN 3** hypertension
- **1 IN 5** is smoker

Coverage - How does the EPF address 22 MILLION ADULT MALAYSIANS



13.7 MILLION
Self-employed and outside labour force

- Depending only on personal savings (Uncovered and under-covered)
  - **NO** formal social protection programme

6.8 MILLION
Private Sector
(EPF Active Members and small portion of active self-employed)

- **Inadequate** monthly pensions ***(under-covered)***
  - **33%** of active members achieve Basic Savings
- **Unsustainable** income replacement for individuals

1.7 MILLION
Civil servants
(including pensioners)

- **Inadequate** monthly pensions ***(under-covered)***
  - **RM2.1k** ***average monthly pension***
- **Unsustainable** pension system design

FORWARD POSITIONING

WHAT A BETTER FUTURE LOOKS LIKE

FINANCIAL SECURITY

Adequate and sustainable income to live and retire comfortably

HEALTHY

Live a healthy life and have access to good medical and nursing facilities

HAPPY & MEANINGFUL LIFE

Financially and physically healthy leads to good mental health and meaningful life

FINANCIAL KNOWLEDGE, ATTITUDE AND BEHAVIOUR OF YOUNG WORKING ADULTS IN MALAYSIA

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Summary

The purpose of this study is to explore the relationship between financial knowledge, attitude, and behaviour among young working adults in Malaysia. The sample consisted of 1,915 young working adults from the Klang Valley in Malaysia. A conceptual model was developed based on the theory of planned behaviour which includes two alternative paths to assess the financial literacy of an individual. Structural equation

"Surprisingly it can be found that financial behaviour is not a strong predictor of financial literacy of young working adults in Malaysia, suggesting future studies to investigate other intervening variables."

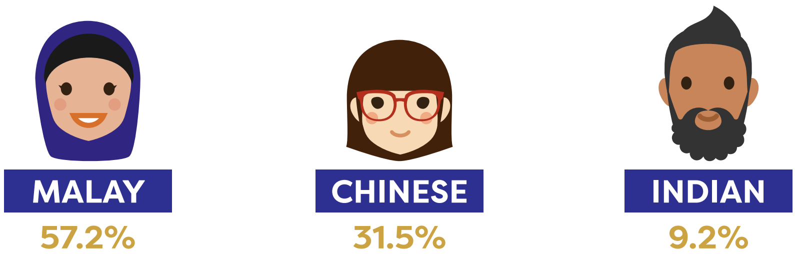
modeling was used to analyse the data. The results revealed that financial knowledge is a significant predictor of financial attitude, and financial attitude fully mediates the relationship between knowledge and behaviour among Malaysians. The financial knowledge scores significantly differs among ethnic groups where the Chinese possess the highest financial knowledge and working adults at the age of 26-30 possess the highest score. Therefore, immediate actions must be taken to mitigate the financial knowledge differences among ethnic groups. Surprisingly it can be found that financial behaviour is not a strong predictor of financial literacy among young working adults in Malaysia, suggesting future studies to investigate other intervening variables. The importance of developing a correct financial attitude among young working Malaysian adults can be highlighted as it is financial attitude that has behaved significantly in the study. The attitude towards the future and non-impulsiveness have to be improved and young working adults must be trained to be achievement oriented. Relevant authorities have to take the initiative to create effective financial education programmes, including increasing the opportunities and ensuring easy access which will generate comprehensive financial knowledge among individuals. This can be achieved through formally arranged financial seminars, workshops, etc. and making financial experts and counselor services more accessible to young adults in the country. In the meantime, initiatives must be taken to communicate to such counselors the importance of changing the overall financial attitude among working adults in Malaysia.

Introduction

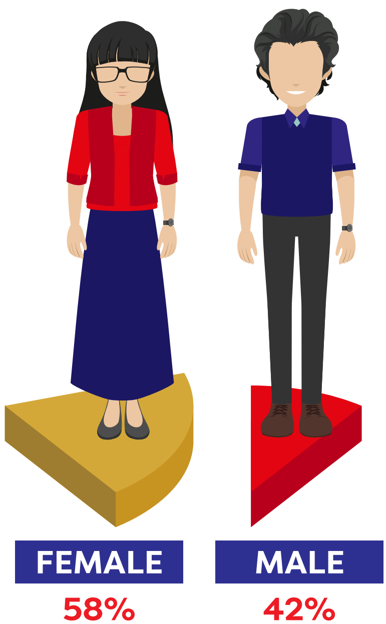
Complex and dynamic businesses and the economic world demand individuals possess strong knowledge on financial matters. The result is a continuous discussion on the importance of financial literacy for a country. Studies prove that individuals with higher financial literacy are always at an advantage and are more empowered compared to others. Further, studies reveal that if a nation is provided with strong financial literacy, the inequality between ethnic groups can be minimised. Hence the undoubted importance of financial literacy for any country.

Fulfilling the paucity of empirical studies in Malaysia, an emerging economy, the current study is intended to explore the relationship between financial knowledge, attitude, and behaviour among young working adults. Standing as a behavioural model on the basis of the theory of planned behaviour, the proposed conceptual model investigated two alternative paths. The data was analysed using structural equation modelling (SEM) with SPSS and Smart PLS software packages. Mediating effects were investigated using the bootstrapping technique.

Approaches and Results



The sample included 1,915 respondents from the Klang Valley in Malaysia who were selected based on simple random sampling. It comprised 57.2% Malays, followed by 31.5% Chinese and 9.2% Indians, which is proportionately consistent with the national population statistics.



The gender composition was 58% female and 42% male. Serving the scope of young working adults, more than 55% of the respondents belonged to the 21-30 age group. Questionnaires were distributed among respondents who are working as managers, professionals, technicians etc. A significant portion of them (22.1%) were either managers or professionals.

The research instrument had separate sections for each construct. Financial education scale items were adapted from Bank. A. N. Z (2015) and a few were self-developed. The scale items for financial knowledge were adapted from Zottel et al, (2013). Financial attitude had two perspectives as "future, non-impulsiveness" and "achievement orientation" which were adapted from Bank. A. N. Z (2015) and self-developed based on Bolaji-Adio et al. (2013), Atkinson and Messy (2012), Zottel et al. (2013). Financial behaviour had four perspectives which were how much the expenses are monitored, saving behaviour, planning for old age and unexpected expenses, budgeting and behaviour of not over spending, living within means, which were self-developed based on Kempson et al. (2013), World Bank (2013), Yoong et al. (2013). Scale items to measure financial literacy were also self-developed based on Kempson et al. (2013), World Bank (2013), Yoong et al. (2013)

Unlike the general assumption on the contribution that financial education can make on financial knowledge, the results revealed that financial education has contributed only 9% of the change in financial knowledge in Malaysia. However it can be found that financial knowledge is a significant predictor of financial knowledge among young working adults in Malaysia. Within the financial attitude, it is the attitude towards "future and non-impulsiveness" that is significant. In simple terms, if an individual has a positive attitude towards planning for the future, be financially secure and mindful of unplanned unnecessary buying, such an individual possesses the correct financial attitude. A full mediating effect of financial attitude was found in the relationship between financial knowledge and financial behaviour. This emphasises the importance of possessing the correct attitude in demonstrating acceptable financial behaviour.

The Chinese possess the highest financial knowledge, followed by Malays and Indians. Even though previous studies proved that there is no age difference in financial knowledge among working adults in Malaysia, the current study found that working adults at the age of 26-30 possess the highest financial knowledge with significant differences with other age groups. Surprisingly it was found that financial behaviour is not a strong predictor of financial literacy among young working adults in Malaysia, requiring future studies to investigate other possible intervening variables.

Conclusion and Implications

The study results challenges general assumptions on the relationships between financial education, knowledge, attitude, behaviour, and financial literacy. Current financial education programs and the knowledge created thereby are not influential enough to make a significant impact on financial attitudes among young working Malaysian adults.

As the results revealed that attitude has a greater impact upon the financial behaviour of individuals, relevant stakeholders have to take initiatives to stimulate the financial attitude of young working adults of the country. Further, the full mediating effect of financial attitudes on the relationship between knowledge and behaviour emphasises the importance of improving the attitudes on financial matters, especially to prevent Malaysians from being impulsive and to have an achievement orientation in terms of finance.

Since the relationship between knowledge and attitude is significant, financial education programmes must generate sufficient financial knowledge for young adults for them to have the correct attitude. Since the indirect relationship between knowledge and behaviour through attitude is higher than the direct relationship, the importance of attitude in building financial literacy among Malaysians, should be understood.

In that respect, families and educational institutions should work hand in hand to address youngsters with an incorrect attitude. Moreover, young working adults must be educated on the importance of setting long term financial goals, monitoring expenditure, planning for old age, and to be prepared for unexpected expenses.

Further, relevant authorities have to take initiatives to make financial advice and counseling services easily accessible for young working adults when they seek it. In the meantime the findings on the importance and the influence of attitude on the overall financial wellbeing of a country must be well communicated to independent financial counselors and advisors for them to make their service fruitful. Meanwhile, financial education programmes should be designed in such a way that they create higher financial knowledge in individuals and thereby engender accepted financial behaviours.

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SAVINGS ADEQUACY ASSESSMENT:
THE CASE OF THE MALAYSIAN EMPLOYEES PROVIDENT FUND MEMBERS

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Summary

This paper examines the potential consequences of early withdrawals from the Malaysian Employees Provident Fund (EPF) on savings adequacy by studying the impact of house purchases on household lifecycle consumption. The paper proposes a strategic repayment mechanism that replicates the optimum operational behaviour of the EPF in an attempt to examine how early withdrawal policies affect the savings adequacy of Malaysian households. In light of the ongoing debate about the adequacy and nature of saving for retirement, the continued growth of the EPF — where pre-retirement cash-outs are more widely available — and increasing life-expectancy, a better understanding of how early withdrawal policies affect retiree choices is essential to develop a retirement income system that can adequately address the needs of the modern work force and the Malaysian economy.

Methodology

We performed a numerical approximation of the solution functions under optimal conditions where members regularly pay their contributions to the EPF, where all members join the workforce and retire at the same age. Subsequently we performed an actuarial evaluation to test the optimal state of the model under six different scenarios: employment periods (18-55 vs. 25-55), retirement periods (55-65 vs. 55-75), real vs. nominal values and asset presence (housing vs. non-housing consumption), annuitisation presence (annuity vs. nonannuity) and historical vs actual contribution rates. Finally, we performed a sensitivity analysis to highlight the impact of housing consumption and inflation on retirement savings.

Major Findings

In the context of early withdrawals, our findings suggests notable differences in retirement income. If retirement savings participation and contributions were not to rise among those who exercise their withdrawal rights – as would be expected given the nonbinding nature of repayment – retirement benefits would not reach the maximum possible level. Withdrawal rights will mainly affect low-income households who cannot easily shift income from alternative sources. In that case, early withdrawals represent an unnecessary loss of retirement savings. Besides, the absence of arbitrage opportunities implies the existence a high degree of uncertainty for household consumption at retirement. The actuarial evaluation findings are consistent with the literature that shows regardless of the nature of a pension scheme – public vs. private,

pay-as-you-go vs. fully-funded vs. provident fund, collective vs. individual accounts – the basic pension period spans from 15 to 20 years, given the income replacement target rate of 60 percent. Given Malaysian macroeconomic data, this period for the EPF is approximately 18 years.

The incorporation of annuitisation at retirement leads to excessive accumulation of assets during the working phase. Using the annuity formula with an assumption of investment returns at the historical EPF rate of 5.95 percent, there is an approximate increase of 71.20 percent in monthly pension income.

The annuity paradigm indicates that the annuitisation method can prove beneficial. Annuitisation decisions though involve important trade-offs and may not be feasible for low-income individuals and for those with low financial assets. It is most likely to benefit the middle and upper income retiree with more assets. However, retirees need to be able to respond to financial shocks in addition to ensuring they do not outlive their income.

Policy Directions

The findings highlight the importance of policies that preserve retirement savings and increase savings for non-retirement events. A restrictive policy on early withdrawals therefore will foster higher potential retirement income.

The EPF ought to allow account withdrawals when a member faces an event requiring unusual financial need and should consider imposing a repayment mechanism. Account withdrawals should be repaid back within a reasonable period of time, usually within a member's working-life, making regular payments of principal and interest, often through payroll deduction. In this context, households have to build up other sources of wealth which they can generate income from to address both expected and unexpected contingencies. Household savings would tend to increase because the EPF account is less liquid than private household wealth. As a result, the precautionary saving motive will be strengthened.

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THE JAPANESE PENSION SYSTEM:
IMPLICATIONS FROM ITS CHALLENGES

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1 Aging Population And Pension System

The Japanese pension system consists of the public pension system and private pension plans (Figure 1). The public pension system is part of Japan's social security system, and consists of the National Pension Insurance (NPI) and Employees' Pension Insurance (EPI). Participation in the public pension system is mandatory. NPI is the basic income portion that covers everybody. EPI is the income replacement portion that covers public and private employees.

Private pension plans consist of two types. The first is the defined benefit type (DB) and the other is the defined contribution type (DC). These plans are voluntary in nature and employers are not required to offer these pension plans. Public employees are covered by DB plans. National Pension Funds (NPFs) and individual DC plans are individual pension plans. Eligible individuals can join them if they wish. NPFs are for the self-employed and individual DC plans are for most of the working-age generations.

“It may be plausible to say that it will put downward pressure on economic growth in the long run, and thus in the future could affect pension schemes’ benefit levels.“

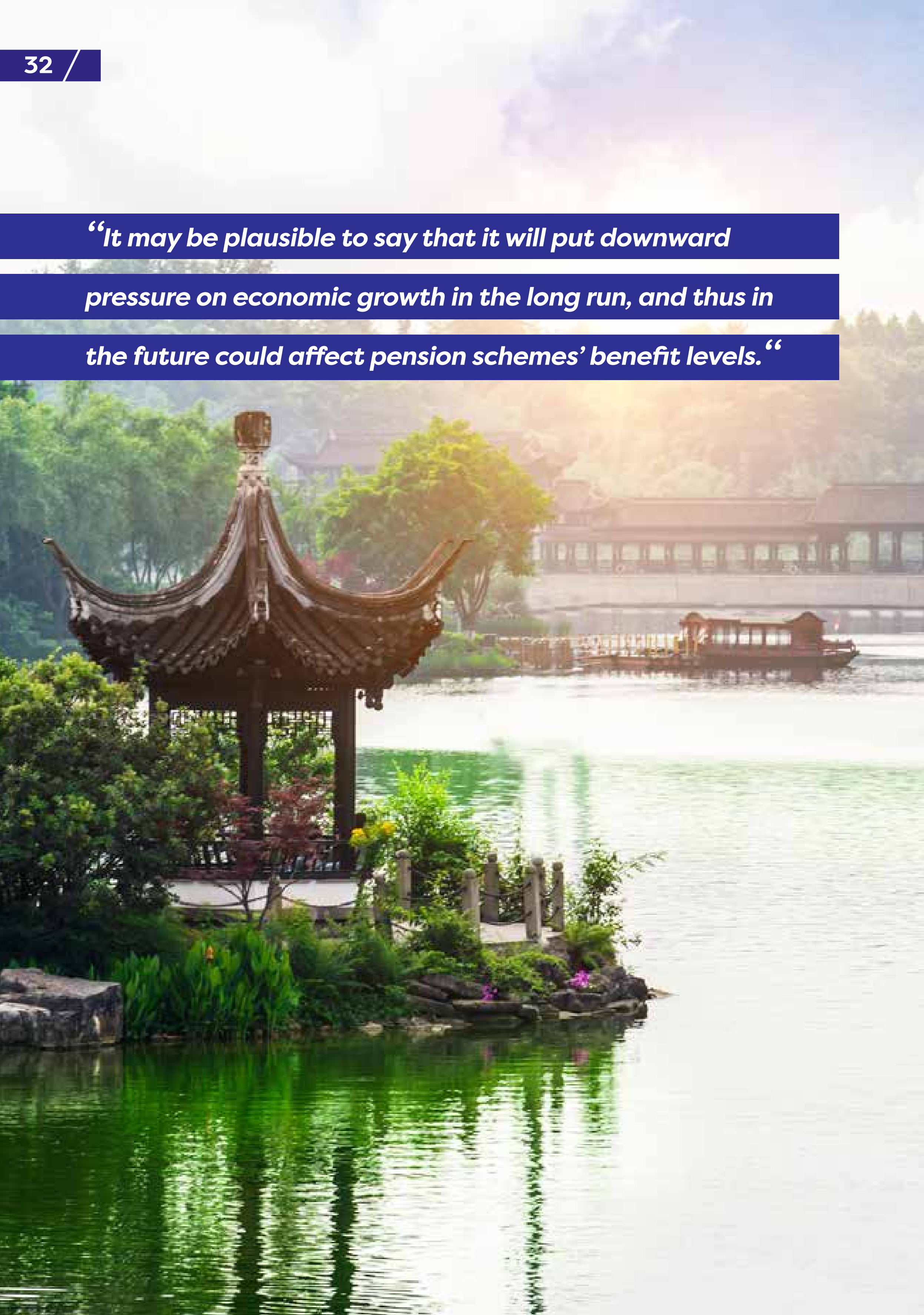
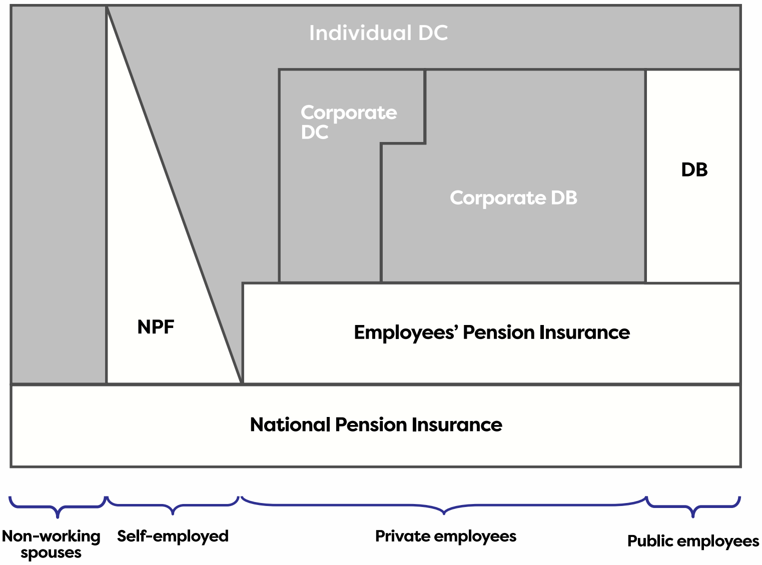


FIGURE 1: JAPAN'S PENSION SYSTEM



Note: 1) White areas are public pension system and government offered pension plans. Gray areas are private pension plans.
2) DC=defined contribution. DB=defined benefit. NPF=National Pension Fund.

Source: Ministry of Health, Labour and Welfare (MHLW), Nomura Institute of Capital Markets Research (NICMR)

2 Rapid Aging Of The Population

The World Bank recommends a multi-pillar pension system and one could say that the Japanese pension system is fairly well balanced with a mix of pension pillars. However, it faces a number of problems. The major cause of these problems is Japan's rapidly aging population.

Japan's public pension is based on the pay-as-you-go funding method used by many other developed countries. The rapid shift in the demographic structure has put a large pressure on public pension finances.

In 1970, 9.8 working-age people (15 to 64 years old) supported each elderly person (65 or older), but that ratio tightened to 5.8:1 in 1990 and 2.2:1 in 2016.

In the 2004 public pension reform, it was decided that the public pension premium would be gradually increased from 13.58% in 2003 to 18.3% in 2017 (paid evenly by employer and employee). The automatic benefit control mechanism was also introduced (details later in this article). In 2012, the law to increase the consumption tax rate was enacted and all additional revenue was earmarked for strengthening social security finances. Despite all these measures, continuous efforts to make the pension system sustainable and adequate are needed.

3 Role Of The Public Pension Reserve Fund

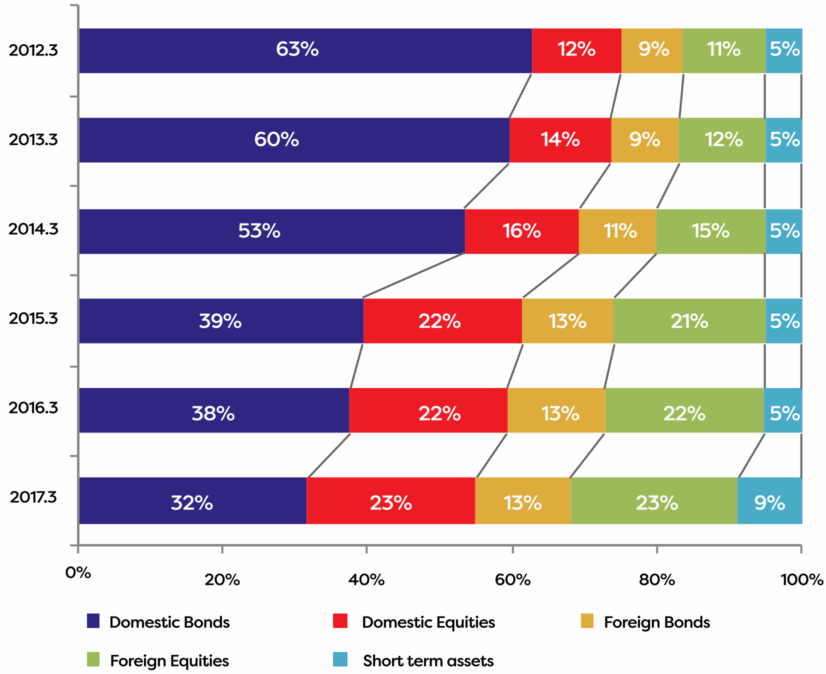
Although its funding method is pay-as-you-go, Japan's public pension system has a fairly large reserve fund. The objective of the reserve fund is to contribute to the financial stability of the public pension system. The fund is managed by the Government Pension Investment Fund (GPIF), an independent administrative agency. As of December 2017, GPIF managed ¥162.7 trillion (US$1.5 trillion). It is the largest pension fund in the world.

It should be noted that even with the reserve fund's size, its investment income alone cannot solve the financial problems of a public pension system with more than ¥50 trillion in annual benefit payments. However, enhancing the investment return can still have a meaningful impact on public pension finances and also to a certain extent over the Japanese asset management industry.

GPIF's investment management historically has been relatively conservative, owing to the legal requirement for "safe and efficient" investments. Two-thirds of its assets under management (AUM) were invested in domestic bonds. The pros and cons of enhancing portfolio investment diversification have been discussed several times, and finally in 2014 it was decided that GPIF should initiate changes. Its policy asset mix was changed from 67% in domestic bonds to 35% in domestic bonds and 50% in domestic and foreign equities, and the actual asset allocation shifted accordingly (Figure 2). It also started investing in alternative asset classes, including infrastructure, private equity and real estate.

GPIF became a signatory of UN PRI in September 2015. Being a long-term and mainly passive investor, commitment to ESG investments made sense for the GPIF, which describes itself as a "super long-term investor" and "universal owner." Strengthening its governance structure was another important change necessitated even more so than before by the GPIF's investment portfolio becoming more sophisticated. A governing body with a collegial structure was introduced in October 2017. Before this change, decision-making power was centralized in the GPIF President. Although the investment committee existed, its role remained in the advisory capacity. The newly established board of governors now makes decision on major issues, including the policy asset mix, and supervises the management of GPIF's executive officers.

FIGURE 2: SHIFT IN GPIF'S ASSET ALLOCATION



Note: Asset allocation of total reserve fund | **Source:** GPIF, NICMR

4 Promoting Private Pension Plans

Image source: *Google*

As mentioned above, the public pension benefit control mechanism was introduced by the 2004 reform. Normally, the public pension benefit is adjusted based on wage and price increases. However, when the benefit control mechanism is initiated, the demographic adjustment factor is applied and wage/price increase is deterred.

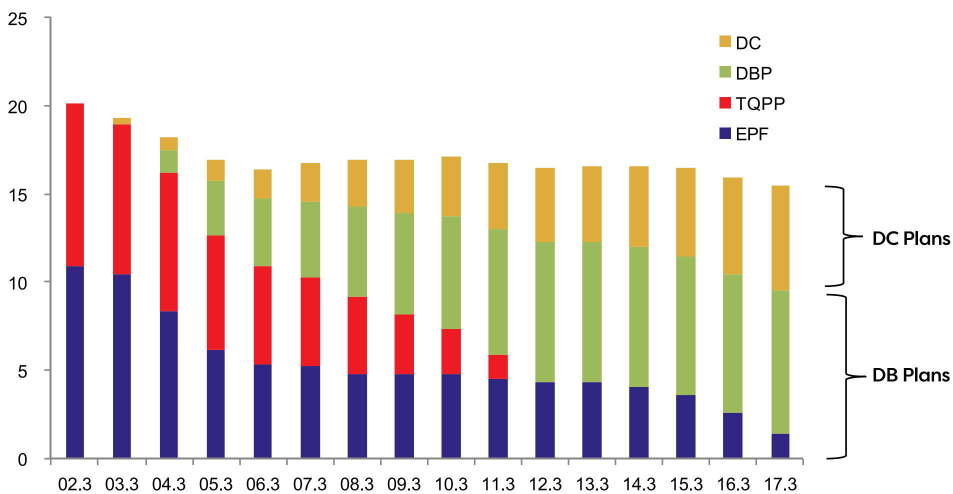
For example, when consumer prices rise 2% and the adjustment factor is 0.9%, the pension benefit increase will be

1.1% and the purchasing power of the public pension benefit will be diminished. This adjustment is expected to gradually lower the pension replacement rate from around 60% to 50%.

Thus it is important that people make up for the difference by using private pension plans. As noted, in Japan there are both DB plans and DC plans. It used to be that in Japan there were only DB plans, but during the 1990s many companies found it difficult to continue offering them due to the economic downturn and weak domestic stock market. DC plans, both corporate and individual, were introduced as new alternatives for private pension plans in 2001.

DC plans have been growing at a steady pace since their introduction. However, overall participation in corporate pension plans has stagnated as shown in Figure 3. Additional measures were needed to change this trend. The DC Law was revised in 2016 and expanded the eligibility of the individual DC plans in order to increase participation.

FIGURE 3: NUMBER OF PARTICIPANTS IN CORPORATE PENSION PLANS



Note: 1) Not adjusted for participants in more than one plan
2) DC=defined contribution, DBP=defined benefit corporate pension, TQPP=tax qualified pension plan, EPF=Employees' pension fund

Source: MHLW, NICMR

Before the 2016 revision, individual DC plans were available only to self-employed people and individuals without a corporate pension plan. This restriction added to the complexity of DC plans, which was detrimental to the expansion of participation.

From January 2017, almost all working-age people became eligible to join individual DC plans if they so choose. There were only 306,000 individual DC plan participants at the end of December 2016, but that number has increased to 854,000 as of the end of March 2018.

It remains to be seen whether this growth will continue.

5 Implications From Japan's Experience

While pension systems are unique to each country, one can still derive some implications from Japan's experience.

First, it is important to assume that population aging will affect the pension system no matter what measures are taken. Malaysia has a multi-pillar pension system with its social assistance scheme, mandatory occupational schemes including EPF, and voluntary schemes. It does not have a pay-as-you-go system with universal coverage like Japan's public pension, so the same type of problems may not occur. However, the impact of population aging is difficult to foresee. It may be plausible to say that it will put downward pressure on economic growth in the long run, and thus in the future could affect pension schemes' benefit levels. In any event, the important thing is to make sure that people of all generations understand what to expect from each pillar.

Secondly, strengthening of voluntary private pension schemes will be needed. Mandatory occupational schemes will always play an important role, but it is good to have as many people as possible join voluntary private pensions. Longevity risk is one obvious reason for accumulating additional assets. It is a wonderful thing to be able to live longer, but one wants to be financially well prepared. A good way to start for Malaysian people is to join voluntary pension schemes.

Thirdly, it would be good to continuously review the philosophy of public pension reserve fund management. Japan decided to enhance the diversification of GPIF's portfolio. Given its size and presence, GPIF's changes will exert some influence over other pension funds' management. As a public entity, its investments also must be aligned with people's expectations in a broad sense. These characteristics are fairly common among public pension fund management and will be shared by Malaysia as well.

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CHARTING YOUR RETIREMENT DESTINY

Citi Malaysia

The world population is ageing and the older population is growing dramatically. According to the United Nations, the number of older persons aged over 60 years is expected to more than double by 2050 and even triple by 2100. Globally, the older population is growing at a
faster rate compared to the younger age groups. This trend if left without an accompanying sustainable plan has deep social, economic, and political implications for the world. What is greatly needed and which can provide the basis to bridging this issue is a strategic roadmap to create opportunities for people to start early investment plans that would enable them to have financially resilient lives during their golden years.

Over and above a financial plan, what is important also is for individuals to examine their own priorities and chart perhaps their retirement dreams on the quality of life they want and how active they plan to be. One needs to ensure that in doing retirement planning, the focus should be on both the accumulation phase and the end goal.

A successful accumulation stage does not equate to successful retirement. Hence, individuals need to think early in the planning process about things like interest and even hobbies. Make a list of potential opportunities and narrow these down to what is most important to you.

According to Wharton University, research indicates that those who are happiest in retirement tend to be happier by giving back and discovering a sense of purpose. What gives you a sense of purpose? What kind of legacy would you like to leave behind? Though subtle, having a goal and purpose in retirement can impact positively the financial plan for retirement. The focus helps individuals to choose the right activities and investments leading up to retirement, thereby reducing short-sighted tendencies.

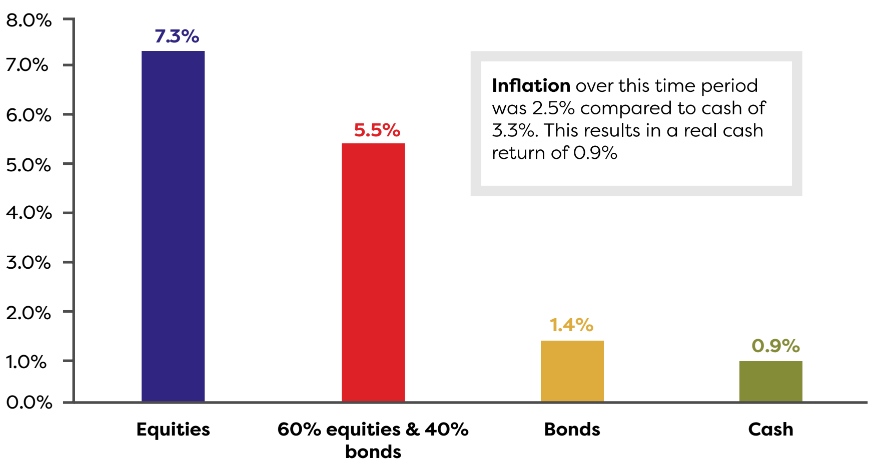
Another important element of retirement planning is the consideration for basic needs, especially affordability and managing medical expenses. In the Asia Pacific region, overall life expectancy in the last 15 years has grown faster than healthy life expectancy. This means that while people are living longer, they are also spending a longer period of their life with disability. It is critical therefore to have in place good quality medical care and retirement care. In a report by the United Nations, public health-care expenditure is low in many Asia Pacific countries, leading to high out of pocket expenditure. The same is observed in Malaysia. Last year, Mercer Marsh Benefits reported that Malaysians faced double-digit healthcare inflation, higher than the average in Asia. Medical costs continue to be a significant portion of retirement expenses.

More often than not, savings alone may not be sufficient in ensuring the sustainability of lifestyles after retirement.

Hence, it is vital that individuals remain committed from young to two simple, yet important principles. First, put savings to work as early as possible as this is the key to successful retirement due to the power of compounding over the long term. In the chart below, we see the real return for two extreme scenarios over the past 15 years in Malaysia, bearing in mind that during this period, the inflation rate was at 2.5%. The important message here is that if we do not put a portion of our savings into investment, our savings will be eroded by the effects of inflation. A portfolio that includes some equity or that is fully invested, may provide more protection against the eroding effects of inflation.

Real returns over the past 15 years (2003-2017)

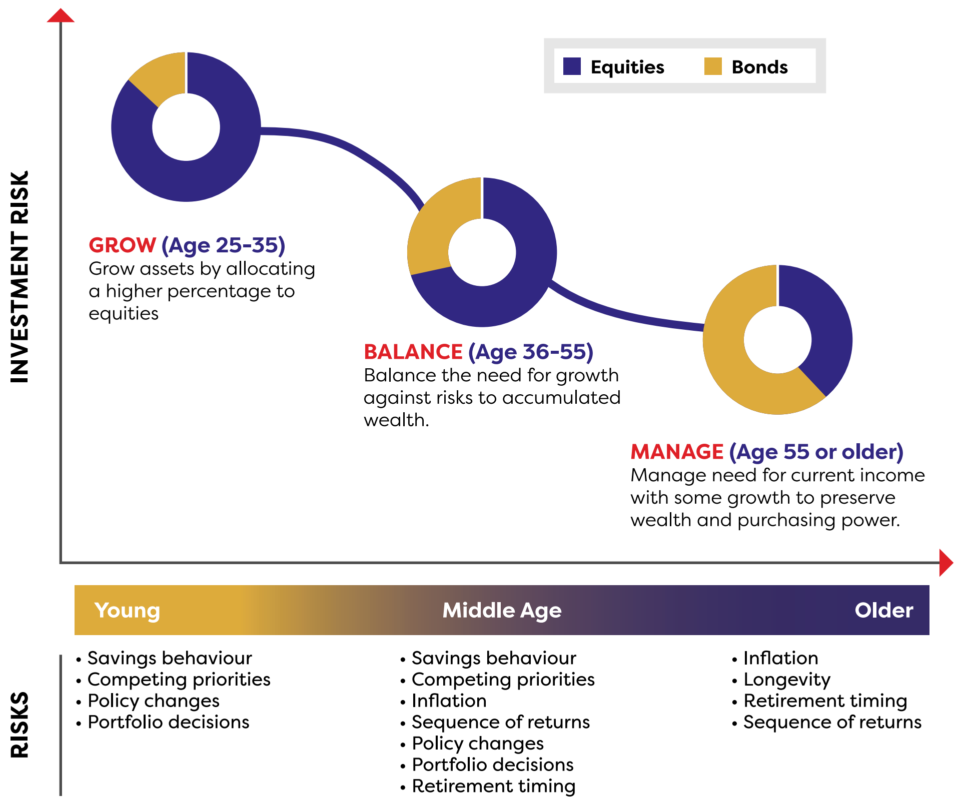
Average annualized return (above inflation)



Real return in the best year:	49.6%	29.7%	3.8%	2.7%
Real return in the worst year:	-41.7%	-24.1%	-2.5%	-1.7%

Source: *J.P. Morgan Asset Management Retirement Series 2018*

You may be slightly alarmed by the real return in the worst year (the Global Financial Crisis in 2008) presented in the chart above. This is where the second principle comes into play namely to invest dynamically over time for a good retirement. Your level of wealth and proximity to retirement should be an influencing factor in determining the risk profile of your investment portfolio. The closer you are to retirement, the lower the feasibility of being fully invested in equities. The chart below tells us that as we age, the risk profile evolves and becomes more conservative with retirement in mind. However, it is also possible for the young to have the risk profile of a middle aged individual. Regardless of any permutation, we need to be clear about our risk tolerance.



Source: *J.P. Morgan Asset Management Retirement Series 2018.*

In many instances, the uncalculated risks of extended longevity and inflation in medical expenses have the potential to throw any retirement plan off course. A retirement financial plan needs clear goals on what we want to achieve during retirement and absolute awareness of potential risks. According to a study by Visa and the Credit Counselling and Debt Management Agency (AKPK), it was revealed that more than 50% of Malaysians may not be financially ready for retirement when the time comes, exacerbated by a low level of financial literacy.

Some practical steps individuals can take to build financial resilience for and during retirement are to first ascertain their total wealth. Secondly, they need to ascertain an appropriate amount for investment and thirdly, to consider the range of investment products or options that are available. One age-old investment wisdom that never goes out of style is asset allocation. Asset allocation can be done by compartmentalising an investment portfolio so that one part provides relatively more protection and another provides a higher risk adjusted return. The best part is that it does not restrict you from investing in illiquid items such as properties. On the other hand, changes in life circumstances will also affect retirement plans. One, however, ought to still make plans and navigate the changes along the way. Be proactive and speak to a financial professional who has the necessary tools to keep tabs on your progress in achieving your retirement goals.

Investing for retirement sustainably with a trusted investment manager will go a long way towards securing a quality lifestyle for an ageing population. It is here that efforts to educate the public on investing for retirement can never be enough and should be done as early as when an individual joins the work force. People close to retiring, or have retired, also need good quality information, advice, and guidance that are pivotal in helping them make informed decisions and continue to be actively engaged in society.

In 2017, Malaysia showed that it had one of the highest levels of financial inclusion among Southeast Asian countries due to openness in financial innovation. This is a great way forward in reconciling the needs of ageing populations, harnessing the use of new technology, and investment trends to bring about positive progress in broadbased financial inclusion.

There are ample investment opportunities in the market for individuals to enrich their retirement years especially in view of the greater longevity and retirement age mentioned earlier. Such opportunities include retirement friendly investment products, better income-generating opportunities for retirees and promotion of affordable longterm care of the aged. Underlying all of this is the critical need for a paradigm shift in mindsets, of incorporating one's life purposes and end goals early into the retirement plan in a strategic and comprehensive manner.

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HEALTHCARE REALLY DOESN'T COST RM1

Azrul Mohd Khalib
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There's much to be proud of when it comes to Malaysia. The previous three decades in particular have brought about development in leaps and bounds which have translated to a better and much improved quality of life compared to that of our parents and grandparents.

It isn't just about the changing physical landscape, diversity of employment, spending power, and the movement of people. Consider, for example, the life expectancy of the average Malaysian. Back in 1970, just several years after the formation of Malaysia, one expected to live up to 64 years. Today, it is 74.7 years, with a male child born in 2016 expected to live up to 72.6 years and a female child, up to 77.2 years.

Much of this is due to a healthcare delivery system on par to that of developed countries which can lay claim to coverage of more than 90 percent of the population being able to access at least basic services within a 5km radius of their home, while 81 percent live within 3km of a health facility. For us, universal health coverage isn't an aspiration, it's a reality.

With charges between RM1 or RM5 for outpatient and specialist care respectively, Malaysians are able to access high quality treatment and care at government clinics and hospitals. At the outpatient level, this could be inclusive of doctor's consultation, some tests, and even a month's worth of medication. Patients pay a fraction of the costs expected for common surgical procedures, such as an appendectomy. In many instances, an appeal can be made for even that to be waived or a further discount to be given.

It is not an exaggeration to say that this healthcare delivery mechanism, comprising both public and private bodies, despite its shortcomings is the envy of many countries in the Asia region, particularly those still developing their economies.

However, it might be past time for us to take an honest look at the system. There are essential overhauls and reforms needed to be done to ensure that healthcare remains accessible, affordable to Malaysians, and most importantly, sustainable for years to come. One such reform urgently needed is in the area of healthcare financing.

Let's face it. Healthcare does not cost RM1. It never has and never will be. Subsidisation is so high that every single patient entering the public system has more than 90 percent of their actual costs borne by the government utilising the public purse.

The purse isn't bottomless and demands on it will get ever bigger. A direct consequence of having people live longer, an increasing ageing population, and more non-communicable diseases, is a health burden which gets progressively larger and heavier each year.

Unfortunately, simply increasing expenditure on healthcare would not solve the problem. It is true that Malaysia currently spends 4.3% of its GDP on health, which is below the average for upper middle-income countries. We could spend more. It is also true that health spending per capita in Malaysia increased 2.5 times in 17 years, from RM641 in 1997 to RM1,626 in 2014. The total healthcare expenditure in Malaysia is RM52 billion with the public-private ratio being 55:45.

The Inland Revenue Board collected RM114 billion last year. It may sound a lot but consider the fact that only 10 percent out of 14 million workers nationwide paid income tax last year. The majority didn't make enough to require them to pay tax. This is also the same source of funding for everything else in the national budget, such as infrastructure development, welfare, education, defence, and sports.

It is easy to point the finger at private clinics and hospitals, the pharmaceutical industry, and other actors in the healthcare sector, and blame them for the escalating cost of medical care. Comparing the amounts paid in the private health sector to the charges in public facilities for similar treatment, more than 39 percent come from out-of-pocket spending with patients and families risking financial trouble, it is understandable for people to get upset and outraged.

But the reality is that there is little difference in actual costs between public and private healthcare delivery. The impression that treatment in public facilities is cheaper is misleading, and creates animosity and hostility towards private service providers. Almost complete subsidisation is increasingly untenable and unsustainable. If we are to ensure and maintain what we have today, urgent reforms are needed.

So what can we do?

The ideal would be for a single-payer, multiple-provider system where public and private institutions would be equally accessible to the patient. This would be the most efficient and cost-effective system. However, it would also require massive upheaval and an overhaul which could be severely disruptive in the short term. It would also necessitate the setting up of institutional structures and systems which might not currently be in place. However, this should be the long term goal.

One approach which we can do now would be to get behind the idea of a voluntary health insurance scheme, an idea currently being seriously considered by the Ministry of Health.

To maintain Malaysia's current two tier system, would require a multi-payer approach. Imagine being able to make a monthly contribution to a national pool of funds similar to what you already do under SOCSO. This would be applicable to all workers and be based on a sliding scale linked to monthly income and age. There would be collective pooling of both funding and risk. People would be able to opt-out.

People already with their own insurance should be able to keep it but also be given the choice to also contribute to the national scheme. They would then be able to access both public and private facilities. Those contributing only to the national scheme would be entitled to access the public healthcare system. The above suggestions do not change much of the status quo regarding access but it does widen the funding base.

It would help begin addressing the issue by co-sharing the burden and responsibility of financing of the healthcare system. It has the potential to stabilise public subsidisation, allow space for cost-containment, while maintaining access and quality to essential services.

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"Sustainable development is the pathway to the future we want for all. It offers a framework to generate economic growth, achieve social justice, exercise environmental stewardship and strengthen governance.

Ban Ki-moon

Many seniors understand that Social Security is social insurance as opposed to a program where we put money aside for our own retirement. But most elderly individuals think they're getting their money back. So it isn't selfishness as much as a misunderstanding

Richard Lamm

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