FINANCIAL PREPAREDNESS AND RETIREMENT PLANNING AMONG EMPLOYEES PROVIDENT FUND (EPF) CONTRIBUTORS

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UNIVERSITI SAINS MALAYSIA

2022

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by

GOH YI YUERN

Thesis submitted in fulfilment of the requirements for the degree of Doctor of Philosophy

February 2022

ACKNOWLEDGEMENT

I am banker and noticed that most Malaysians barely have a decent life after retirement. For this reason, I decided to write this thesis. The first person I want to thank most is my supervisor Dr**.** Loke Yiing Jia @ Loke Weng Kah. My thesis would have not been complete without her valuable guidance and support. She has continuously encouraged and supported me with her ideas, views and insights and time throughout this gratifying journey. I spend a long time writing the thesis. First, I would like to thank Universiti of Sains Malaysia (USM), which has offered me many valuable classes or webinar such as SPSS, logistic regression analysis, writing skill and thesis formatting with MS Word to further enhance my knowledge. Furthermore, I would like to thank all my family members especially my husband and father for their invaluable support and encouragement during this long journey. Last, I would like to thank my friends especially Dr. Htoo Htoo, Dr. Holly, Dr. Yong, Jason, and Lian Yee, who have inspired me to complete this thesis and always gave me energy from it start until the end.

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LIST OF ABBREVIATIONS

AHEAD	Asset and Health Dynamics
AKPK	Agensi Kaunseling & Pengurusan Kredit
BOT	Bantuan Orang Tua
B40	Bottom 40% of income earner
BRIM	The 1Malaysia People's Aid
CPF	Central Provident Fund
DOSM	Department of Statistics Malaysia
EBM	Engel, Blackwell and Miniard
EKB	Engel, Kollat, and Blackwell
EPF	Employee Provident Fund
FIMM	Federal of Investment Managers Malaysia
FMIs	Financial Management Institution
FOR	Future of Retirement
GP	Government Pension
HRS	Health and Retirement Study
HSBC	The Hongkong and Shanghai Banking Corporation Limited
IIA	Independence of Irrelevant Alternatives
JEPeM	Jawantankuada Etika Penyelidikan Manusia
KRI	Khazanah Research Institute
KWSP	Kumpulan Wang Simpanan Pekerja
LR	Likelihood Ratio
LTAT	Lembaga Tabung Angkatan Tentera
MIS	Member Investment Scheme
M40	Middle 40% of Income Earner
OECD	Organization for Economic Co-operation and Development
PRS	Private Retirement Scheme
SCF	Survey of Consumer Finances
SOCSO	Social Security Organization
T20	Top 20% of Income Earner
VIF	Variance Inflation Factor

LIST OF APPENDICES

PERANCANGAN PERSARAAN DAN KESEDIAAN KEWANGAN DI KALANGAN PENYUMBANG KUMPULAN WANG SIMPANAN PEKERJA (KWSP)

ABSTRAK

Skim Kumpulan Wang Simpanan Pekerja (KWSP) ditubuhkan pada tahun 1951 bagi melindungi simpanan pesaraan untuk tenaga kerja di Malaysia. Namun demikian, terdapat ramai ahli aktif dalam KWSP yang mendapati bahawa tabungan KWSP mereka tidak mencukupi bagi menyara keperluan mereka dalam tempoh persaraan. Oleh itu, kajian ini telah dijalankan untuk menentukan faktor-faktor yang mempengaruhi keputusan ahli KWSP untuk merancang simpanan pesaraan selain simpanan KWSP dan menganalisa faktor-faktor yang menyumbangkan kepada kesediaan kewangan pesaraan pencarum KWSP. Ini merupakan objektif pertama dan kedua kajian ini. Dalam objektif ketiga kajian ini, analisis statistik deskriptif melalui ujian khi kuasa dua digunakan untuk meneroka hubungan antara ciri sosio-demografi dan saluran simpanan pesaraan pilihan ahli KWSP. Sebanyak 500 soal selidik diberikan kepada ahli KWSP yang bekerja di kawasan Kuala Lumpur dan Selangor dan kemungkinan mempunyai rancangan simpanan persaraan dan kategori kesediaan kewangan persaraan dikaji dengan menggunakan model regresi Logistik dan model regresi Logistik Multinomial masing-masing. Pembolehubah sosio-ekonomi (bilangan tanggungan, tahap pendapatan dan tahap pendidikan) dan sifat keperibadian (perspektif masa depan, kawalan diri, penundaan dan toleransi risiko), penggunaan penasihat kewangan didapati mempunyai pengaruh yang signifikan dalam pembelian rancangan simpanan persaraan. Kedua, tahap pendapatan dan komitmen kewangan (bilangan tanggungan) menjadi penghalang utama terhadap kesediaan kewangan persaraan. Penemuan dari objektif ketiga sebenarnya memberikan gambaran mengenai pilihan simpanan persaraan berdasarkan kumpulan sosio-ekonomi dan maklumat tersebut akan membantu pembuat dasar di bank untuk memposisikan produk kewangan persaraan untuk pelanggan-pelanggan di bank. Kajian ini menyimpulkan bahawa perhatian khusus harus diberikan kepada ahli KWSP yang berpendapatan rendah, kerana adalah mencabar bagi mereka untuk merancang simpanan persaraan dan didapati kurang bersedia dari segi kewangan untuk persaraan. Di samping itu, kajian ini menekankan peranan positif penasihat kewangan dalam kemungkinan individu mempunyai rancangan simpanan persaraan dan mengesyorkan agar peranan penasihat kewangan diberikan lebih penekanan untuk membantu individu dalam merancang kewangan persaraan.

RETIREMENT PLANNING AND FINANCIAL PREPAREDNESS AMONG EMPLOYEES PROVIDENT FUND (EPF) CONTRIBUTORS

ABSTRACT

Established in 1951, the Employees Provident Fund scheme made it compulsory for Malaysian workforce to save for their retirement. However, many of the employee provident fund contributors found that their Employees' Provident Fund (EPF) savings are not enough to sustain them through retirement. Thus, this study was conducted to identify factors that affect an EPF contributor's decision to have planned savings for retirement besides employee provident fund savings and to analyse factors that contribute to EPF contributor's financial preparedness for retirement. These constitutes the first two objectives of this study. In the third objective, the study uses descriptive statistical analysis to explore the relationship between socio-demographic characteristic and preferred retirement saving channels. A total of 500 questionnaires were administered to those working in Kuala Lumpur and Selangor area. The likelihood of having a personal retirement saving plan and the categories of retirement financial preparedness were analysed using Logistic regression model and Multinomial logistic model respectively. Socio-economic variables (number of financial dependents, income level and education level) and personality traits (future time perspective, self-control, procrastination, and risk tolerance), and engagement of financial advisors were found to have significant influence on purchasing a retirement savings plan. Second, income and financial commitment (financial dependents) are major deterrents towards financial preparedness for retirement. The findings from the third objective actually provides insight on retirement saving preference based on socio-economic groups and such information helps policy maker in the bank to position their retirement financial products for bank customers accordingly. The study concludes that special attention should be given to low-income earners, as they find it more challenging to plan a retirement saving plan and were found to be less financially prepared for retirement. Additionally, the study highlights the significant positive role of financial advisor in the likelihood of individual having a retirement saving plan and recommends that the role of financial advisor to be given more emphasis to assist individuals in retirement financial planning.

Chapter 1

INTRODUCTION

1.1 Introduction

The work life cycle encompasses young adulthood until mid-adulthood (prime earning years), and retirement. Retirement is the point of life when an individual permanently terminates employment either when on reaching the legal retirement age or when the individual desires and has the necessary means to terminate employment permanently. According to the Minimum Retirement Age Act 2012 (Act 753), the minimum age of retirement for an employee in Malaysia is 60 years old (Attorney General's Chambers of Malaysia, 2018). Generally, retiree would experience a shortfall in their income when they are no longer working. Retiree inevitably turn to personal savings as a primary source of income to meet their daily needs (Russell and Stramoski, 2011). A comprehensive retirement plan involving diversified investments during active work-life is fundamental, as the savings generate a small income upon retirement. Therefore, retirement planning is vital for financial independence after retirement.

Elder and Rudolph (1999) defined retirement planning as planning one's finances for individual health and well-being after retirement. Retirement preparedness is part of the retirement planning process. Wynaendts (2017) defined retirement preparedness as the ability to have an enjoyable retirement that requires careful financial planning and good health maintenance. In short, retirement preparedness and retirement planning are required to ensure a comfortable retirement. The Association of Superannuation Funds of Australia (ASFA) defines a comfortable retirement as a retiree's ability to engage in all the recreational activities they enjoy and purchase household goods, private health, insurance, a reasonable car, goods, clothing, electronic and travelling (AFA, 2022). In United Kingdom, the comfortable retirement standard allows retirees just meeting the basic needs. Importantly, it enables retirement retirees to do a lot of things that individuals would like to do (Padley and Shepherd, 2017). In Malaysia, according to the Employees Provident Fund (EPF, 2016), comfortable retirement occurs when an individual has financial security with good health and a happy, meaningful life. However, retirement may not be possible for most people, especially young adults due to low wages and the high cost of living. Individuals need to start saving and planning early to secure their future and have a comfortable retirement. As part of retirement planning, it is crucial for individuals to accurately assess their financial status to guarantee comfortable retirement (Krishnan *et al*, 2018).

Despite the importance of financial preparedness for retirement planning, only 46% of Malaysian respondents stated that they would start preparing for retirement when they hit 50. Besides, reports also showed that only 14% of Malaysians knew how much they needed as retirement income (Loh, 2010). In addition, the AXA Retirement Scope 2010, a global retirement study conducted by French multinational insurance firm, AXA Group, across 26 countries, including the United States, Malaysia, Japan, China, United Kingdom, and Australia, showed that Malaysians were among the least prepared for retirement with only 38% starting to prepare for retirement at the average age of 39 (Loh, 2010).

According to Arfudi (2015), a study from Nielsen Malaysia indicated that close to 79% of Malaysians were not prepared for their retirement. It can be concluded that level of retirement preparedness is low in Malaysia. Only 40% of Malaysians are financially well-prepared for their retirement and more than 75% of Malaysians found it difficult to save RM1,000 cash for emergency needs due to economic uncertainties and high living expenses (The Edge Markets, 2017). In 2019, a survey conducted by

The Khazanah Research Institute (KRI) showed that close to 40% of Malaysian workers including those in full-time employment do not have any retirement savings plan (Pfordten and Chung, 2020). Accordingly, this situation may worsen with an aging Malaysian population. A survey carried out by Bank Negara Malaysia and the Securities Commission of Malaysia in 2020 found that close to 53% out of 10,628 respondents were unable to survive more than three months being unemployed while 46% of respondents spent beyond their means (RinggitPlus, 2020). Based on these studies, it can be concluded that Malaysians have low financial preparedness for retirement.

In Malaysia, EPF is a retirement savings scheme that mainly provides retirement savings for employees in the private sector. However, most of EPF contributors have wrongly perceived that their EPF or retirement savings are sufficient for their entire lifespan (Afthanorhan *et al,* 2020). According to EPF (2018), 68% of active EPF contributors do not have a minimum savings of RM240,000 that each EPF contributor should have upon reaching the age of 55 to support their basic needs, and 70% of active EPF contributors aged 54 have less than RM50,000 in their EPF account. The report also showed that every 7 in 10 Malaysians would live with RM210 per month until 75 or spend all their EPF savings in less than two years. On average, active EPF contributors only achieved a minimum savings of RM185,146 far lower than the prescribed minimum retirement savings (EPF, 2019). The increase in life expectancy of Malaysians (72.6 years for men and 77.6 years for women) also influences the amount of retirement savings to lead a comfortable lifestyle (Department of Statistics Malaysia, 2020). In other words, an EPF contributor will live approximately another 12 to 17 years after retiring at the age of 60 and would need sufficient funds to sustain their basic lifestyle after retirement. Early retirement plans that complement EPF savings are vital to financially prepare for a secure future.

1.2 The Importance of Financial Preparedness for Retirement Planning

There is an urgent need for financial preparedness for retirement planning due to

longer life expectancy, rising cost of living and medical care, Further, changes in the family structure also reduce the dependency of retirees on care and support from their children. The discussion below examines these in further detail.

1.2.1 Longer Life Expectancy

The life expectancy of Malaysians has increased, notably in the last two decades. The Statistics Yearbook of Asia and the Pacific in 2019 suggests that the life expectancy at birth for a Malaysian was 70.7 years in 1990 (Asian Development, 2019), whereas in 2020, life expectancy has increased to 74.9 years old (Department of Statistics Malaysia, 2020). Figure 1.1 shows the comparison between the life expectancy among the males and females’ population in Malaysia from 1950 to 2019. In 1950, the life expectancy of Malaysian female and male was 54.4 years old and 52.5 years old respectively. In 2019, Malaysian female had a higher life expectancy of 77.3 years old while males had a life expectancy of 72.2 years old. For the past 69 years, the life span of Malaysians has steadily increased.

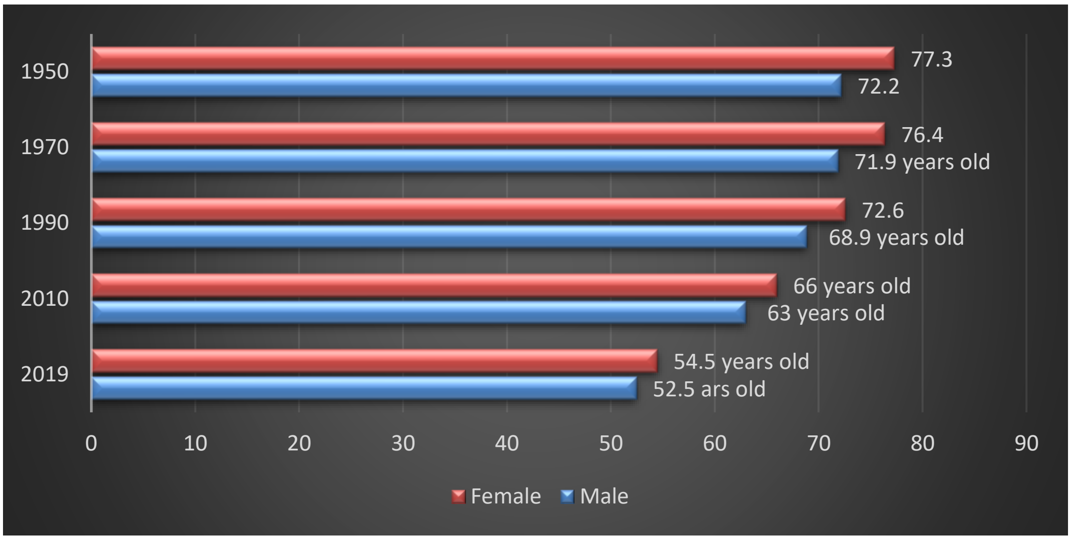


Figure 1.1: Life expectancy from 1950 to 2019 in Malaysia
Source: Department of Statistics Malaysia 2019a

A study by the World Bank 2020 also predicted the proportion of Malaysians aged 65 years old and above will increase to 14% by 2044 (The World Bank, 2020). By 2056, almost 20% of Malaysians will be 65 years old and above. These statistics show that Malaysians have a longer life expectancy, and those aged 60 years and above will constitute a large segment of the Malaysian population in the near future. Due to higher life expectancy, retirement savings have to last for a longer time. Thus, financial preparedness and retirement planning are essential.

1.2.2 Rising cost of living and medical care

Malaysia is heading towards an ageing society and therefore, retirees live longer after retiring. Retirement planning is essential to cope with the rising cost of living and medical care. The rising cost of living in Malaysia is contributed by the lack of fuel subsidies, the weakening global economy, tumbling currency and political instability (Hamid and Rashid, 2012). According to the data collected by Iprice group Sdn Bhd, the cost of living of a single individual in Kuala Lumpur is estimated to be about RM3,236, whereas the minimum salary in Malaysia is RM1,200 (The Malaysian

Reserve, 2020). It can be concluded that low income families will find it very difficult to save after spending daily expenses.

The rising costs of living, particularly medical costs, may strain any individual's finances. In 2012, a study conducted by Swiss Re entitled "Health Protection Gap: Asia-Pacific 2012", revealed that the total medical costs in Malaysia are projected to rise by 8.8% yearly to RM103.3 billion by 2020 (Malaysian Journal of Nursing Online News Portal, 2012). This will require additional spending or higher out-of-pocket funding by individuals, and this particularly worries senior citizens who are financially unprepared for retirement and are struggling to meet their daily expenses. According to the report from Global Medical Trend 2021, it was revealed that medical cost in Malaysia is one of the highest in the Asian countries. On the average, the gross medical inflation rate in Malaysia is about 15.3% in 2018, 16.1% in 2019 and 14% in 2020, and this is showed that utilization of health care has seen a rise in family (AON, 2020). According to report from Department of Statistics Malaysia indicated that heart diseases is one of top killer diseases in Malaysia (Department of Statistic Malaysia, 2021). For example, treatment for heart disease such as a coronary bypass in public hospital would cost up to RM4,500, (Ministry of Health, 2021), compared to the cost in private hospital that would be between RM25,000 to RM80,000 (Muniapan and Zakaria, 2019). Therefore, retirees also need to have savings as a backup for medical emergencies.

Apart from the rising cost of living, the rising medical care costs makes it difficult for retirees who need medical care. Therefore, making provisions for medical care forms an essential part of financial preparedness and retirement planning.

1.2.3 Changing family structure

With an aging population, the financial burden of caring for the elderly will increase. The average fertility rate of Malaysians was three babies per family in 2000 and the figure is reduced to 1.90 babies in 2019 (Department of Statistics Malaysia, 2019a). In many Asian countries such as Malaysia, Singapore, and China, where filial piety is emphasized, working adults are expected to take care of their aging parents. The family structure of Asian countries has changed drastically over the years due to smaller household sizes. The smaller family sizes strain the family support system of caring for the old. According to Hassan *et al*, (2016), children would need to contribute more money to their retired parents in smaller family sizes than those with larger family sizes. As a result, the responsibility of smaller family sizes to take care of older parents becomes more challenging if parents are financially ill prepared for retirement. Therefore, individuals need to plan for their retirement finances and there is an urgent need to introduce long-term personal retirement plans, so that frail and older individuals can have sufficient funds to support themselves financially when they retire without being dependent on their children.

According to Manulife's report, the Manulife Investor Sentiment Index survey in the first quarter in 2014 has reported 44% of the senior citizens in Malaysia financially support themselves and their spouse. When retirees lack sufficient retirement savings, they become financially dependent on their children (Manulife Investment Management, 2014). Restricting their freedom lead to family tension. Furthermore, according to the report of Manulife, 75% of retirees would like to spend more time with friends and family, while 62% of retirees would like to take frequent holidays and 48% of retirees would prefer to start a business (Market Screener， 2014). Due to their lack of financial independence, such aspirations are unfulfilled. In addition, dependency inevitably places higher financial pressure on their children.

1.3 Challenges of Financial Preparedness for Retirement Planning

Despite the importance of financial preparedness for retirement planning as discussed above, many Malaysians find it challenging to plan and prepare for retirement financially.

There are two type of retirement plans which provide some form of retirement income for Malaysians in Malaysia. There are defined contribution plan and defined benefit plan. The major schemes are Government Pension (GP), Employees Provident Fund (EPF), and the recently established Private Retirement Scheme (PRS) to complement EPF. The Government Pension covers workers employed in the civil service, while EPF is Malaysia’s retirement savings fund that provides economic security for employees in the private sector. In addition, civil servants also have the option to contribute to EPF. There are 7.36 million active EPF contributors that account for 45% of the total labour force in Malaysia as of 2018 (Department of Statistics Malaysia, 2018). Therefore, EPF contributors are the majority of the labour force in Malaysia and represent the best sample to examine the current state of financial preparedness for retirement among Malaysians.

Malaysians experience a variety of challenges that pose a barrier to them being ready for retirement. The list of retirement challenges faced by Malaysians when it comes to plan retirement savings including limitations in the EPF savings, low replacement rate, low-income families, low contribution rate in EPF, financial attitudinal factors, lack of access to a financial advisor and inadequate retirement savings in existing retirement scheme.

1.3.1 Limitations of EPF savings

EPF being the main retirement savings fund for most privately employed workers has several limitations, resulting in insufficient savings and unable to provide workers with adequate retirement savings during retirement. The section below discusses the various factors that contribute to inadequacy of EPF savings, including lack of funds in the EPF account, low contribution rate, flexible withdrawal schemes and low take-up rate of Members' Investment Scheme.

a. Insufficient retirement savings in EPF account

Despite EPF being the main retirement scheme in Malaysia, it was found that EPF could not provide sufficiently for a comfortable retirement. For example, based on the EPF's recent statistics in 2018 (Table 1.1), most EPF contributors could not achieve the minimum saving of RM240,000 when EPF contributor reached aged 55. Based on the calculation in EPF report, each of EPF contributor between aged 45 to 50 years old, 51to 55 years old and age 56 to 60 years old only met the average of basic EPF saving with amounting RM189,000, RM201,000 and RM139,000 respectively (EPF, 2018).

With effect from 1st January 2019, EPF raised the recommended minimum savings threshold for individuals aged 55 from RM228,000 to RM240,000 (EPF, 2019). The recommended minimum savings refers to the savings in the EPF Account 1. Based on the recommended minimum savings of RM240,000 at the age of 55, EPF contributors would be able to spend up to RM1,000 a month for the next 20 years of their life. The amount of RM1,000 is still below the poverty line, the average household income of RM 2,208 (as of July 2020), and lower than the minimum wage of RM1,200 in

Peninsular Malaysia (Economic Planning Unit, Prime Minister's Department, 2020). In other words, it raises the question of whether the minimum salary of RM1,200 would still leave many EPF contributors below the poverty line. Another report by EPF (2014) pointed out that more than 50% of EPF contributors above 55 would have exhausted their savings in five years. These alarming statistics highlight the retirees' sole dependence on their EPF savings as their main source of funds upon retirement and the inadequacy of EPF as a form of retirement savings.

Table 1.1: Active members' profile by savings range and age as at 31 December 2018

Age Group	Total members	Total member (%)	Total Savings (RM)	Total Savings (%)
<16	173	0	96,971	0
16-25	1,484,402	20.17	10,026,496,319	1.64
26-30	1,417,181	19.25	36,491,695,354	5.96
31-35	1,142,573	15.52	67,465,909,982	11.02
36-40	873,604	11.87	87,141,633,989	14.23
41-45	733,309	9.96	106,748,304,322	17.43
46-50	622,030	8.45	117,813,877,230	19.24
51-55	503,583	6.84	101,352,075,991	16.55
56-60	343,143	4.66	47,850,186,333	7.81
61-65	153,741	2.09	22,840,528,334	3.73
66-70	62,775	0.85	9,633,210,658	1.57
71-75	19,602	0.27	3,928,876,057	0.64
76-80	3,841	0.05	1,018,654,150	0.17
81-85	261	0.00	55,081,947	0.01
>85	30	0.00	7,390,960	0

Source: EPF Annual Report 2018

b. Low Contribution Rate

The contribution rate started at 10% in 1952. This figure was a combination of the employee and employer contribution. In January 1993, the contribution rate gradually increased to 22% (12% contributed by the employer and 10% by the employee). In 1996, the total combined contribution rate from the employee and employer increased to 23% of the wages with the employee and employer contributing 11% and 12% of the employee's monthly wages (EPF, 2018). After the economic crisis in 2001, the employee contribution rate reduced from 11% to 9%, and in 2008, a reduction to 8%. Due to the COVID-19 pandemic, a reduction in the employee contribution from 11% to 9% was imposed for a period of one year (i.e., January 2020 to December 2020). Krishnan *et al*, (2018) explained that as long as the contribution rate does not fulfil the maximum of 23% or 24%, this will result in inadequate EPF savings.

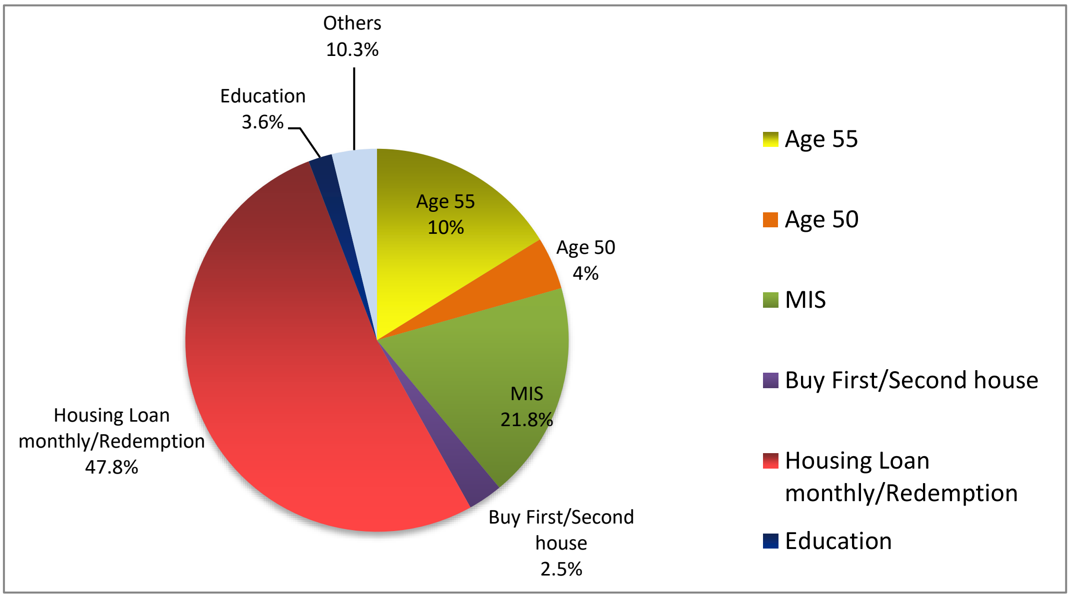
In Malaysia, employees in the private sector aged below 60 years old earning RM5,000 and above are obligated to contribute 11% of their monthly salary while the employer contributes 13%. Those earning a monthly salary above RM5,000 would have 24% of their monthly income held in EPF. However, those aged 60 to 70 years only contribute 5.5%, whereas the employer contributes 6.5%. Where the monthly salary exceeds RM20,000, the contribution by the employee and employer is 11% and 12%, respectively.

Under the Organization for Economic Cooperation Development (OECD), 33 member states maintained the total mandatory contribution rate of 18.4% for an average income earner (OECD, 2019). In Singapore, the Central Provident Fund Board (CPF) has a total contribution rate of 37% (CPF, 2016). Every Singaporean below 55 and in employment is obligated to pay 20%, and the employer contributes 17% to the CPF. In comparison to the Singaporean CPF, the EPF has a lower contribution rate.

c. Flexible EPF Withdrawal before Retirement

To facilitate EPF contributors to prepare for a comfortable retirement, the EPF allow EPF contributors to make a partial or full withdrawal of their saving to meet the specific retirement related needs that are in line with the EPF' s current policies. A 70% of the member's saving will be kept in Account I for retirement which is in line with the EPF's primary objective. EPF contributors are allow to withdrawal fully from Account 1 and Account 2 upon reaching age 55. If EPF contributor choose to continue working after age 55, all further contributions will be credited into Akaun Emas and only be withdrawn at age 60. In addition, qualified EPF contributor allowed to withdraw from Account 1 to do investment in approved unit trust. The minimun investment amount is RM1,000, and EPF contributor may transfer up to a maximum of 30% of the total basic savings surplus in Account 1 to invest (EPF, 2022).

Figure 1.2: Type EPF Withdrawal Scheme (2018)



Source: EPF Annual Report 2018

The EPF scheme allows members to withdraw their EPF savings from account 2 for various reasons and withdrawals is a general feature of provident fund. When an

EPF contributors attains 50 years old, EPF can make a one-time partial withdrawal of all or part of savings in Account 2 to help on planning for retirement. Pre-retirement withdrawal from account 2 can also made for the purpose of pre-retirement such as to build house, to buy house, to reduce or redeem a house installment, to settle medical related bill, education, and to perform the Haji. For example, EPF contributor can withdraw their savings in Account 2 to finance the purchase of a house and withdraw to purchase a second house is allowed after the first house disposal of ownership of property has taken place. EPF contributor also can withdraw their savings in Account 2 to pay for housing loan monthly installment taken for the purpose of purchasing or building a house. This is an addition to the existing withdrawal, which is the withdrawal to reduce or redeem housing loan (EPF, 2022). According to EPF (2018), most of EPF active members have made EPF withdrawals and the average amount of withdrawal is RM125,000. A majority of the EPF's active contributors (54%) have withdrawn from their EPF account. Overall, the total number of withdrawal applications has increased by 3.84% to 3.89 million to RM48.15 billion, through various withdrawal schemes in 2017 but has reduced to RM47.3 billion in 2018.

Figure 1.2 shows the share of types of withdrawal made in 2018. From Figure 1.2, it is found that number of withdrawals applications to pay housing loans and redemption (47.8%) accounts for the biggest shares of EPF withdrawal, followed by Member Investment Scheme (21.8%). In 2018, 47.8% of total number of withdrawal applications amounted to a sum of withdrawal equivalent to RM3.4 billion to pay for housing loans and redemption purposes, while 2.5% of total number of withdrawal application amounted to a sum of withdrawal equivalent to RM2.3 billion withdrawal for the purchase of a first or second home. In contrast, only 10% of number withdrawal applications were made by those aged 55 and 4% of number withdrawal applications by those aged 50 for retirement purpose. It is evident that many EPF members utilized the withdrawal flexibility offered by the EPF for other purposes, especially for housing loans. Therefore, the withdrawal of funds before retirement affects EPF savings resulting in

insufficient funds for retirement.

d. Low take up rate of Members' Investment Scheme

Apart from allowing its members to withdraw to pay for various needs as explained above, the EPF has also introduced to Members Investment Scheme (MIS) to expand investment options. This scheme allows member to transfer a portion of their savings from Account 1 for investment to increase their retirement savings. Under scheme, members can invest through Fund Management Institutions (FMI) appointed by the EPF with no more than 30% every three months of the total savings from Account 1 in excess of their respective Basic Savings (EPF, 2018).

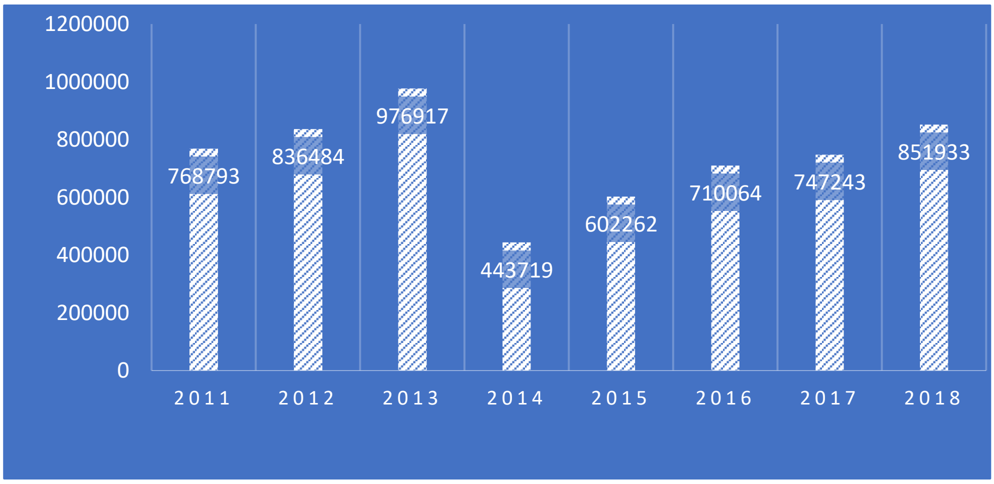


Figure 1.3: Total application for withdrawal in Member Investment Scheme (2011-2018)
Source: EPF Annual Report 2018

Based on Figure 1.3, withdrawal for Member Investment Scheme only account for 21.8% of the application in 2018. Figure 1.3 shows the total number of withdrawal applications from 2011 to 2018. The highest number of EPF numbers who applied for the Member Investment Scheme was in 2013 (976,917 members), However, there was a decrease to 443,719 EPF members in 2014. In the subsequent years, the number of EPF members who joined the Member Investment Scheme withdrawals was still lower than 2013.

1.3.2 Low Replacement Rate

Another challenge in retirement planning is the low replacement rate among individuals. The replacement rate refers to the percentage of a worker's pre-retirement income paid out by a pension program upon retirement. On the other hand, the gross replacement rare is the gross pension entitlement divided by gross pre-retirement earning (Organization for Economic Cooperation and Development, 2018). Pension at a Glance Asia/ Pacific 2013 reported that gross replacement rate in Malaysia stands at only 35.1%, which is much lower than the average gross replacement rate for the OECD countries in 2013 (OECD, 2013a). However, by 2018, the gross replacement rate in Malaysia has improved at 85.5% for males, and 78.9 % for females (OECD, 2018).

The net replacement rate is defined as the individual's net pension entitlement and these are net pre-retirement earnings, taking into account personal income tax and social security contributions paid by workers and pensioners (OECD, 2018). The income tax system plays an important role in old age financial support. Retirees do not pay social security contributions and personal income taxes as pension entitlements are lower than earnings before retirement. In addition, the average tax rate on pension income is typically less than the tax rate on earned income. Furthermore, income tax systems give preferential treatment either to pension incomes or to retirees, by giving additional allowances to older individuals. As a result, net replacement rates are usually higher than gross replacement rates. The net replacement rate is usually higher than gross replacement rates. The net replacement rate across OECD countries is 63.1% for males and 62.5% for females, and the net replacement rate in Malaysia is only 85.5% for males, and 78.9 % for females in 2018 (OECD, 2018).

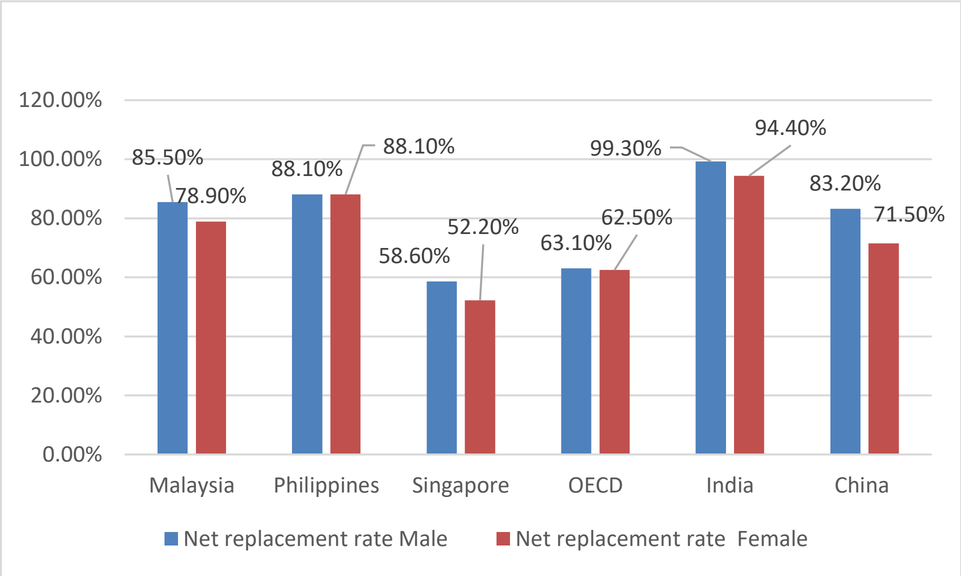


Figure 1.4: Net replacement rate in Selected Asian Countries and OECD in 2018
Source: OECD 2018

The average net replacement rate in Malaysia is 82.2 % (OECD, 2018). This rate is still lower than other Asian countries such as the Philippines and India. As shown in Figure 1.4 (Organization for Economic Cooperation and Development, 2018) existing retirement programs such as EPF are unlikely to meet individuals' retirement needs in providing sustainable and adequate finances for retirement. A higher replacement rate through combine EPF savings and other investment savings such as Private Retirement Scheme (PRS), insurance and fixed deposits, then they are able to attain a higher replacement rate and are more likely to be comfortable in retirement.

1.3.3 Low Income

Many low-income families struggle to save and typically have little left after spending on monthly necessities. Therefore, most low-income households have very low saving and limited asset accumulation. For example, HSBC Survey found that most Malaysians spent up to 41% of their monthly household income on housing loan payments, 22% on education fund and 19% to pay on debt (HSBC，2015). This finding constitutes almost half of their monthly income, excluding other financial expenses. Table 1.2 shows that almost 60% of EPF member's monthly salary is less than RM2,000 which explains the low accumulated savings among most EPF members with low wage that affects their EPF contributions.

Table 1.1 Active member's profile by salary range as of 31st December 2016[1]

Salary Range	Active Members	Percentage	Accumulated
<RM500	571,730	8.60%	8.60%
RM5,00-RM1, 000	1,438,650	21.60%	30.20%
RM1,001-RM2000	1,973,192	29.60%	59.80%
RM2,001-RM,3,000	1,043,645	15.70%	75.50%
RM3,001-RM5,000	905,577	13.60%	89.10%
RM5,001-RM7,000	314,993	4.30%	93.40%
RM7,001-RM10,000	200,986	3%	96.40%
>RM10, 000	209,977	3.40%	100%

Source: EPF Annual Report 2016

HSBC has reported that from a survey conducted by HSBC between July to August 2012, showed that 48% of workers found it difficult to save for retirement because of housing costs and the need to pay for their children's education in 2013 (Twigg, 2013). Similarly, 2,062 graduates with an average salary of RM2,500 echoed the same sentiments in a survey conducted by JobStreet (New Straits Times, 2014). In

[1] This value in Table1.2 is for 2016 and not 2018 as such data was no longer reported after 2016.

conclusion, savings for retirement planning are challenging for low-income earners due to their other commitments.

1.3.4 Financial Attitudinal Factors

The financial attitudinal factors play a key role in financial preparedness and retirement planning. In today's society, many working adults are more inclined to 'live for the present'. This is supported by data collected from RinggitPlus survey on Malaysian financial behaviour. The report showed that near to 45% of respondent spend or more than what they earn and 55% have not started plan for retirement planning (RinggitPlus, 2021). According to Hershfield (2013), individuals tend to spend a large proportion of their income on vacations, home renovations, or buying vehicles than saving and planning retirement. Data from Department of Statistics Malaysia (2019b) showed that an average Malaysian household spend on expenses related housing which come up to 23.6% of the total spending. Coming in at second is food and drink, encompassing 17.3% of total spending, and follow by transportation (13.5%) and eating outside and restaurant (13.3%). Besides the house's utility and foods are considered basic necessities, the finding showed that an average Malaysian spend 26.8% on entertainment and car. In addition, an average Malaysian spent RM229 a month on mobile and internet. The high expenses on entertainment, car, mobile and internet suggest that people tend to live for today. Many postpone or procrastinate retirement planning. According to Twigg (2013), a survey from the Future of Retirement 2012 concluded that retirement was not the main savings priority for 85% of working adults. The report also showed that approximately one-third of the respondents surveyed (37%) prioritized saving for a holiday over retirement. In a survey conducted by Manulife in the 1st quarter of 2014, most respondents believed they could afford a desirable retirement. Only 19% of Malaysians viewed retirement savings as a top priority and ranked the lowest in Asia (Manulife Investment Management, 2014).

These findings show that Malaysians place a low priority on retirement planning due to the lack of awareness of the importance of retirement planning. Unless individuals are aware of the importance of retirement planning, their behaviour will not change (Knoll, 2010). In addition, financial literacy can also help individuals plan their finances for retirement more effectively. The 2012 Report stated that more than one in five (22%) working adults and nearly three in ten (29%) retirees do not know how much they need to save for a comfortable retirement (HSBC, 2013). On the other hand, the Manulife survey found that 33% of the respondents aged 25 and above are the primary decisions makers in a household on financial matters. Such individuals have not started planning for retirement and do not intend to do so as they feel their bank balance would cover their needs upon retirement (Manulife, 2013). Based on the surveys and reports, it is apparent that the lack of financial literacy and awareness on the importance of retirement planning may be important causal factors in preventing early financial planning for retirement.

The Edge Markets (2019) reported that one of the reasons that individuals do not engage in a retirement plan is the lack of financial literacy. According to the S&P Global Financial Literacy Survey in 2015, Malaysia ranked 66th in financial literacy. The respondents had to answer five basic financial literacy questions, including compounding interest and inflation that Malaysians found challenging to answer. This is consistent with the study by Delafrooz and Laily (2011) on the correlation between savings and financial literacy. Poor financial knowledge and planning skills can affect the ability to secure a comfortable retirement. Retirement planning is a complicated process that requires a certain level of financial literacy as concluded by Mullock and Turcotte (2012), Van Rooij *et al,* (2012), Lusardi (2009), and Lusardi and Mitchell (2008). The results of the survey by Prudential Assurance Malaysia showed that 77% of Malaysians placed their money in low-yielding savings or financial instruments, such as bank fixed deposits and savings accounts, where returns could easily be out-run by inflation (Hunt, 2009). The lack of financial literacy among Malaysians is evident in the survey conducted by Manulife Malaysia (2014), where 2% of Malaysian respondents correctly answered the 5 questions in the International Financial Literacy Benchmark quiz (Digital New Asia, 2014).

1.3.5 Lack of Utilization of Financial Advisor

The lack of access to a financial advisor also contributes to poor and inadequate retirement planning in Malaysia. HSBC (2010) reported that 73% of Malaysians do not seek the advice of financial professionals when they are unaware of the potential sources of retirement income. According to HSBC (2012), the findings of a survey involving 1,000 individuals aged 25 and above revealed that 53% of them used approximate calculations to plan their retirement finances instead of engaging a financial advisor. The survey also showed that people who sought professional advice tend to save more. Out of the respondents who sought the services of professional financial advisors, 60% could save more for retirement, and 67% had savings for retirement.

In light of the various challenges and risks that affect the welfare of retirees, the lack of retirement planning and increasing shortfall of EPF savings are of grave concern. In particular, EPF is the main retirement scheme for most private-sector employees who account for 45% of the total labour force in Malaysia. A better understanding of the significant factors that affect financial preparedness for retirement planning is required to mitigate the likelihood of retirement poverty or retirement crisis in Malaysia. Given the liberal and competitive landscape of financial services, it is of interest to industry players such as financial institutions to understand individual preferences of retirement savings channels to develop products that meet the customer's needs and characteristics. Based on the discussions above, this thesis aims to explore and investigate the factors that affect the decision by EPF contributors in making plans for retirement savings, financial preparedness and the preferred choice of retirement savings channel.

1.4 Problem Statement

EPF is the main source of retirement savings for privately sector workers in Malaysia and it provides for approximately 45% of the total labour force in the country. However, in recent years, growing number of studies have shown that EPF savings are inadequate to sustain its members through retirement (Jomo, 2017). As highlighted, the inadequacy of EPF savings is due to various reasons such as low salary, low contribution rates, the high utilization of the flexible pre-retirement withdrawal facilities by members for purposes other than retirement and the low participation rate of the Members Investment scheme have exacerbated the low accumulate EPF savings situation.

Apart from the issue of inadequate EPF savings, the majority of EPF contributor have low salary with a monthly salary less than RM2,000 and the result showed that most of them were unable to meet the recommended minimum savings of RM240,000 at age 55. Given that the life of expectancy of Malaysians has been to 74.9 years old in 2020, it is assumed that with the minimum savings of RM240,000, an individual will have to survive with a monthly income of less than RM1,000, granted that there are no major medical expenses and debt. Hence, EPF contributors can barely enjoy a comfortable life in his retirement. Furthermore, the relatively low contribution rate of EPF as compared to a neighbouring country such as Singapore which has similar retirement savings fund (CPF), the high utilization of flexible pre-retirement withdrawal facilities has further exacerbated the low accumulated EPF savings situation.

In view of the rising cost of living, the changing demographic structure of the Malaysian population and family units, poor attitudinal behaviour towards retirement planning, a comfortable retirement becomes a challenge unless individuals take concrete and proactive steps to plan for retirement as early as possible.

In order to avoid old age poverty and retirement crisis in Malaysia, it is pertinent to investigate if EPF contributors save for retirement in other forms of personal financial products apart from their monthly contribution to EPF and what are the factors that play a significant role towards that decision. Do individuals take the initiative to subscribe to these alternative retirement investment products to complement their EPF retirement savings funds? Furthermore, are EPF contributors prepared financially for retirement and what are the factors that can significantly contribute to their financial preparedness for retirement planning? As there are now various retirement investments options that complement existing retirement schemes such as the EPF, what are the socio-demographics characteristics that are associated with an EPF contributor's retirement savings channel preference?

1.5 Research Question

The study seeks to address the following research questions:

i. What are the factors that affect an EPF contributor's decision to have planned savings for retirement besides EPF savings?

ii. What are the factors that significantly contribute to the state of an EPF contributor's financial preparedness for retirement?

iii. How do socio-demographic characteristics associate with EPF contributors' retirement savings channel preferences?

1.6 Research Objective

The primary objective of this thesis is to examine EPF contributor's financial preparedness for retirement planning. The specific objectives of the study are as follow:

i. To identify the factors that affect an EPF contributor's decision to have planned savings for retirement besides EPF savings.

ii. To analyse factors that contribute to the state of an EPF contributor's financial preparedness for retirement.

iii. To explore the relationship between socio-demographic characteristics and EPF contributors retirement savings channel preferences.

1.7 The Scope of the Study

The study is focused on EPF contributors aged between 20 years old to 50 years old who are living and working full time either in Kuala Lumpur or Selangor area. As EPF contributors account for 45% of the total labour force in Malaysia, they provide the best sample on the current status of Malaysians' financial preparedness for retirement planning.

1.8 Significance of Study

According to HSBC global report in 2015, near to 80% of Malaysians are worried that they will not have enough savings to retire before retirement (HSBC, 2015). It is obvious that financial anxiety has become the biggest pressure towards Malaysians. With this type of fear hanging over the head, it is difficult to enjoy retirement life. Hence, the findings of this study could provide the government and private sector insights on the state of retirement planning and financial preparedness among EPF contributors. Furthermore, the findings from this study will enable a better understanding on the various factors that can significantly play a role in motivating retirement savings planning and that influences the different categories of financial preparedness for retirement.

Furthermore, in the analysis on the relationship between EPF contributors' socio-demographic characteristics and their preferences of retirement savings channel, financial service providers particularly the banks can have a better understanding on individual preferences and would be able to target the retirement savings products more effectively according to individual's socio-economic characteristics. These will help in improving retirement savings planning and financial preparedness of EPF contributors.

1.9 Organization of Study

The subsequent discussions are organized as follow by Chapter 2 presents a background of existing retirement schemes in Malaysia. Chapter 3 discusses related theories and a review of relevant empirical literature, while chapter 4 presents the