Private Retirement Scheme

Examination Study Guide

FIMM

Federation of Investment Managers Malaysia

PRIVATE RETIREMENT SCHEME

EXAMINATION STUDY GUIDE

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Revised Edition 2015

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PRS EXAMINATION STUDY GUIDE

OBJECTIVE

This study guide is designed to prepare a candidate for the PRS examination. Upon completion of the study guide, the candidate should be able to understand and explain the:

- nature and constitution of the structure of PRS;
- retirement needs of an individual and steps to be taken to ensure adequate retirement savings;
- regulatory framework governing the PRS and role of the SC;
- roles and functions of key components of the PRS framework including the PRS Providers, Scheme Trustees, the Private Pension Administrator (PPA) and the PRS Distributors and Consultants;
- need for a suitability assessment and the importance of investing in the right fund; and
- compliance requirement of the relevant laws and guidelines in terms of the code of ethics and standards of professional conduct.

CONTENTS

GLOSSARY AND ABBREVIATIONS

accrued benefits	means the amount of a member's beneficial interest in a PRS
auditor	means an auditor registered under section 31O of the *Securities Commission Act 1993*
CMSA	means the *Capital Markets and Services Act 2007*
collective investment schemes	means, for the purpose of this study guide, schemes or any arrangement where– (a) it is made for the purpose, or having the effect, of providing facilities for persons to participate in or receive profits or income arising from the acquisition, holding, management or disposal of securities, derivatives or any other property (referred to as "scheme's assets") or sums paid out of such profits or income; (b) the persons who participate in the arrangements do not have day-to-day control over the management of the scheme's assets; and (c) the scheme's assets are managed by an entity which is responsible for the management of the scheme's assets and is approved/authorised/licensed by a relevant regulator to conduct fund management activities; and includes among others, unit trust funds, real estate investment trusts, exchange-traded funds, wholesale funds and closed-end funds
conditionally vested unit	means a unit which accords a member with entitlement to the unit that is conditional upon fulfillment of condition(s) stipulated in a vesting schedule
contribution	means the amount paid by a contributor to the PRS
contributor	means any person who contributes to a PRS and includes a member or an employer who makes contribution to a PRS on behalf of his employees

core funds	core funds are mandatory funds that must be offered in each PRS and comprises the conservative fund, moderate fund and growth fund
default option	core funds that will be selected automatically for a member who does not specify his or her fund option upon participating in a Scheme
eligible market	means a market that– (a) is regulated by a regulatory authority; (b) operates regularly; (c) is open to the public; and (d) has adequate liquidity for the purposes of the fund in question
EPF	means the Employees Provident Fund (Kumpulan Wang Simpanan Pekerja)
EPF Act	means the *Employees Provident Fund Act 1991*
financial institution	(a) if the institution is in Malaysia– (i) licensed bank; (ii) licensed finance companies; (iii) Islamic bank; or (iv) licensed institutions (b) if the institution is outside Malaysia, any institution that is licensed/registered/ approved/ authorised to provide financial services by the relevant banking regulator
forward price	means the price of a unit that is the NAV per unit calculated at the next valuation point after an instruction or a request is received
fund manager	means a person who holds a Capital Markets Services Representative's Licence to carry on the regulated activity of fund management
group of companies	means any company and its related corporations
Government	means the government of Malaysia
independent member	In relation to the board of directors of a PRS Provider, the investment committee of a fund, the Shariah

adviser and the panel of advisers, refers to a person who is free of any relationship with the PRS Provider or the controlling shareholder(s) of the PRS Provider that would otherwise interfere with the member's or person's exercise of independent judgment. In any case, a period of six months must elapse before a person who was previously connected to the PRS Provider or controlling shareholder(s) can be deemed to be independent. The following is a non-exhaustive list of persons who would not be considered as an "independent member":

(a) An officer of the PRS Provider;

(b) An officer of the Scheme Trustee;

(c) An officer of any body corporate or unincorporate that has the power to appoint or make recommendations towards the appointment of the board of directors of the PRS Provider, members of the investment committee, the Shariah adviser and the panel of advisers of the fund;

(d) A person related to an officer of the PRS Provider or Scheme Trustee of the Private Retirement Scheme;

(e) A person representing or perceived to be representing any body corporate or unincorporate with a controlling interest in the PRS Provider; or

(f) A person who, within six months prior to his appointment as independent member, has derived any remuneration or benefit (other than retirement benefit) from the PRS Provider or any body corporate or unincorporate that has power to appoint or make recommendations towards the appointment of board of directors of the PRS Provider, members of the investment committee, the Shariah adviser and the panel of advisers of the fund

IRB	means the Inland Revenue Board (Lembaga Hasil Dalam Negeri)
KWAP	means the Retirement Fund Incorporated (Kumpulan Wang Persaraan [Diperbadankan])
LTAT	means the Armed Forces Fund Board (Lembaga Tabung Angkatan Tentera)

member	means an individual who has a beneficial interest under a PRS or an employer-sponsored retirement scheme
NAV per unit	means the NAV of the fund divided by the number of units in circulation, at the valuation point
net asset value (NAV)	means the value of all the fund's assets less the value of all the fund's liabilities at the valuation point *For the purpose of computing the annual management fee, annual trustee fee and annual Private Pension Administrator fee, the NAV of the fund must be inclusive of the management fee, trustee fee and Private Pension Administrator fee for the relevant day"*
non-core funds	refers to the funds under a Scheme that are not core funds
ordinary resolution	means a resolution passed by a simple majority of votes validly cast at a meeting of members of the Scheme or the fund (where appropriate)
portfolio turnover ratio (PTR)	means the ratio of the average sum of acquisitions and disposals of the fund for the year to the average value of the fund for the year calculated on a daily basis, i.e. $\dfrac{\text{[total acquisitions of the fund for the year + total disposals of the fund for the year] / 2}}{\text{average value of the fund for the year calculated on a daily basis}}$
pre-retirement withdrawal	means withdrawals from any fund under a Scheme that occurs prior to a member reaching retirement age and for the following reasons: (a) Upon the death of a member; or (b) Permanent departure of a member from Malaysia; or (c) Withdrawal of any accrued benefits from sub-account B as maintained by PRS Providers for each member
Principal	in relation to a PRS Consultant, means the PRS Distributor that the PRS Consultant represents
private pension account	means an account opened and maintained by the Private Pension Administrator for each member

Private Pension Administrator (PPA)	means a person who is approved under section 139C of the CMSA to perform the function of record keeping, administration and customer service to members and contributors in relation to contributions made in a PRS and such other duties as may be specified by the SC
Private Retirement Scheme (PRS) or Scheme	means a retirement scheme governed by a trust, offered and provided to the public for the sole purpose, or having the effect, of building up long term retirement for members
PRS Consultant	means an individual PRS Consultant registered with FIMM to market and distribute PRS
PRS Distributor	means any one of the PRS Providers, institutional PRS advisers and corporate PRS advisers registered with FIMM to market and distribute PRS
PRS Guidelines	means *Guidelines on Private Retirement Schemes*
PRS Provider	means a person who provides and manages a PRS
PRS Regulations	means the *Capital Markets and Services (Private Retirement Scheme Industry) Regulations 2012*
retirement age	means the age of 55 years or any other age as may be specified by the SC
SC	means the Securities Commission Malaysia established under the *Securities Commission Act 1993*
Scheme Trustee	means a trustee of a PRS
SOCSO	means the Social Security Organisation (Pertubuhan Keselamatan Sosial)
special resolution	has the same meaning as given under the PRS Regulations except for the purpose of winding up a fund, a special resolution is passed by a majority in number representing at least 3/4 of the value of the units held by members voting at the meeting
sub-account A	refers to a sub-account maintained by PRS Providers for each member which holds 70% of all contributions made to any fund under the Scheme which is reflected in units
sub-account B	refers to a sub-account maintained by PRS Providers for each member which holds 30% of all contributions made to any fund under the Scheme which is reflected in units

vested unit	means a unit which accords a member with unconditional entitlement to such unit
vesting schedule	refers to the schedule that determines the entitlement of an employee's accrued benefits based on terms of service

CHAPTER 1

INTRODUCTION TO THE PRIVATE RETIREMENT SCHEME INDUSTRY

Learning objectives

This chapter focuses on the basics of the Malaysian pension and retirement system, the World Bank's multi-pillar pension framework and the need for Malaysia to develop the private pension industry.

At the end of this chapter, you should be able to:

- describe the current state of the Malaysian pension and retirement landscape and its key players;
- describe the World Bank's five pillars framework for pensions and how it applies to the Malaysian context;
- give examples of the Schemes under the different pillars;
- recognise the need for higher retirement savings;
- explain the need to develop a private pension industry; and
- describe the benefits of the PRS.

1.1 The Malaysian pension and retirement landscape

The Malaysian pension and retirement landscape may be categorised along two distinct lines:

- public sector versus private sector pension schemes; and
- mandatory versus voluntary pension schemes.

Public sector and private sector schemes

Public sector schemes tend to be defined benefit plans in which the beneficiaries do not contribute at all to their retirement.

Two examples of the public sector schemes are the Kumpulan Wang Persaraan (Diperbadankan) (KWAP) and the Lembaga Tabung Angkatan Tentera (LTAT). The KWAP provides pensions and other benefits for retired civil servants while the LTAT provides the same for retired armed forces personnel.

On the other hand, private sector schemes tend to be defined contribution schemes where there is a direct linkage between the amount contributed, the returns of these contributions and the resultant pension nest egg.

Two examples of private sector schemes are the EPF and the employer-sponsored retirement schemes. The EPF is governed by the *Employees Provident Fund Act 1991* (EPF Act) and reflects the contributions of both employee and employers. The employer-sponsored retirement scheme refers to a retirement scheme established by a corporation in order to provide benefits to employees of that corporation or for its related corporation. It comes under the purview of section 150 of the *Income Tax Act 1967* (Revised-1971) which provides a tax incentive for employers to contribute towards their employees' retirement savings.

Mandatory and voluntary pension schemes

Mandatory pension schemes are retirement schemes that are mandated by law. In Malaysia, all private sector employees have to participate in the EPF scheme by contributing a portion of their salary (currently the contribution is mandated at 11%) towards their retirement savings. The majority of these savings can only be withdrawn at the retirement age and the rest of the contribution can only be withdrawn under specific circumstances.

Voluntary pension schemes, as the name suggests, are retirement schemes that are voluntary and unlike the EPF, the minimum contributions to the voluntary schemes are not mandated by law. Currently, an example is the employer-sponsored retirement scheme. The purchase of annuities qualifies as voluntary schemes. The PRS initiative falls under this category.

(a) The adequacy of individual retirement savings

The average retiree in Malaysia faces the real issue of adequacy of retirement savings and whether these savings will last, given the uncertainty of life expectancy and capital erosion with inflation. The tables below illustrate the amount needed to sustain a suitable life-style post-retirement.

Amount of lump sum needed at the onset of retirement, assuming a life expectancy of 20 years post retirement and an ability to invest the lump sum at 2% per annum:

RM2,000 per month required in retirement	RM392,434.40
RM3,000 per month required in retirement	RM588,651.60
RM4,000 per month required in retirement	RM784,868.05

The table below shows the amount of savings per year needed to achieve the lump sum above, given the years available to save (until retirement) and assuming the individual can invest and compound the savings at 4% per annum:

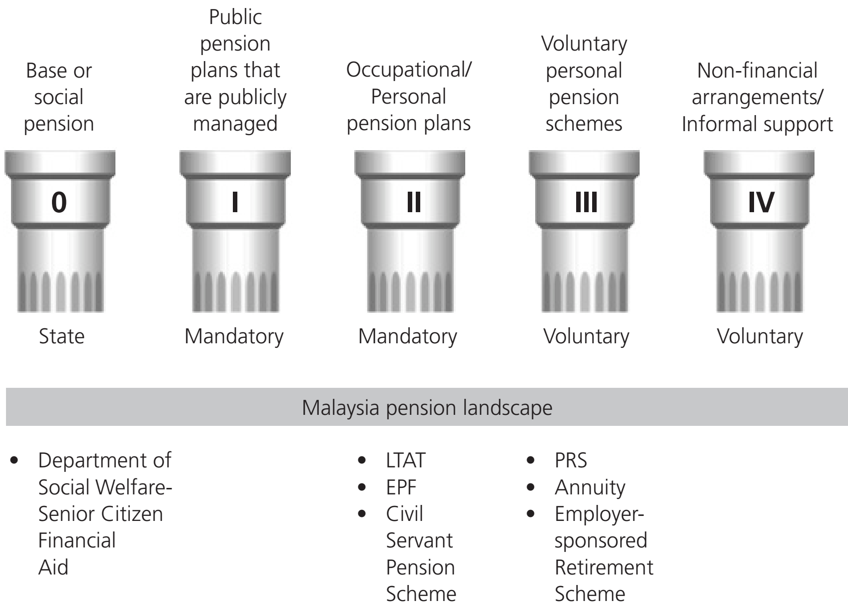
Years available to save	30 years	20 years	15 years	10 years
RM2,000 monthly requirement	RM6,997	RM13,179	RM19,599	RM32,686
RM3,000 monthly requirement	RM10,495	RM19,768	RM29,398	RM49,029
RM4,000 monthly requirement	RM13,994	RM26,357	RM39,197	RM65,372

So for example, an individual who is 40 years old and wants to retire in 15 years' time with a retirement income of RM3,000 a month would need to save RM29,398 a year, assuming he can invest this at 4% per annum over the next 15 years while saving for retirement. Changing the variables such as the time to accumulate the savings, the investment interest rates and the required retirement income would of course change the calculation but the crux of the matter is that there is a need for an individual to put aside a substantial amount of savings to achieve a post-retirement life-style that is acceptable.

Hence, there is a necessity to prepare an appropriate retirement savings plans so that the individual will have a sufficient nest egg come retirement. This nest egg should be made up of mandatory savings of the EPF and supplemented with voluntary schemes like the PRS. Both are necessary to ensure sufficient retirement savings. The EPF will provide the minimum savings and the PRS will help maintain a life-style that the retiree desires.

To determine the required income for the retiree, there is a need to understand the "income replacement ratio" which is the percentage of working income that an individual needs to maintain the same standard of living in retirement. This ratio is usually between 60% and 90% of the working income before retirement. A retiree who attains this replacement ratio through a combination of EPF withdrawal and current income through investments like the PRS and fixed deposits will be in a comfortable state come retirement.

(b) The World Bank's Pension Conceptual Framework



(i) The five pillars framework

The World Bank's policy framework applies a five pillar model when evaluating a country's pension and social security reform efforts. The World Bank is of the view that a multi-pillar approach provides for more flexibility and is therefore better able to address the needs of the target segments of the population as well as provide a better safe guard against any economic, political and demographic risks faced by a specific pension system.

(ii) The five pillars in the Malaysian context

The following section conceptualises the World Bank multi-pillar framework within the Malaysian context.

A non-contributory "pillar zero"

The World Bank sees this as a general social assistance financed and provided by the local or national government to ensure people with low lifetime income are basically cared for in their old age.

In Malaysia, the Social Welfare Department provides financial aid to low-income citizens and this includes old age financial aid on a means test basis.

A mandatory "first pillar"

This pillar aims to link contribution to varying degrees of earnings with the objective of replacing some portion of lifetime pre-retirement income. These defined benefit plans are usually financed on a pay-as-you-go basis and subjected to demographic and political risk.

This pillar of the pension framework is not available in Malaysia but an example of this "first pillar" would be in Japan where employees pay a portion of their income to the national pension system which aims to provide a "basic pension" to all residents in Japan. The basic pension for the elderly is payable to a pensioner at the age of 65 if the person has paid premiums for 25 years or longer.

This pillar is said to be subjected to demographic risks because, as our example in Japan shows, the rapidly greying population puts enormous strain on the funding. With fewer and fewer younger employees to support the growing number of pensioners, there is a shortfall in contributions to meet pension disbursements and there is considerable pressure on the government to help fund the pension system.

A mandatory "second pillar"

This is typically an individual's savings plan i.e. a defined contribution plan where there are wide options in investment vehicles, investment managers and withdrawal phase selections. Defined contribution plans provide the individual with a clear link between contributions, investment performance of the savings and end benefits.

In Malaysia, this pillar includes the EPF, the KWAP and the LTAT.

A voluntary "third pillar"

This pillar can take many forms (defined benefit or contribution plans, individual savings plans) but it is essentially discretionary and flexible. This third pillar's flexibility compensates for the rigidity of the other pillars and allows the individual to complement whatever is perceived to be lacking in the individual's retirement planning.

For Malaysia, this is where the PRS will feature. Other schemes under this pillar include the private investment/saving schemes for individuals (unit trusts, fixed deposits and insurance products), employer-sponsored retirement scheme approved under section 150 of the *Income Tax Act 1967* (Revised-1971), additional contributions to the EPF, annuities and unfunded occupational gratuity scheme.

The PRS is being introduced to supplement EPF savings (for employed persons) and other second pillar schemes. Although the EPF can be considered an unqualified success with comprehensive coverage for the employed sector and with healthy returns over the years in spite of the global financial crisis, it is not mandatory for the self-employed. Amongst the aims of PRS is to encourage this segment of the population to start saving earnestly for their retirement.

Furthermore, studies have shown that most retirees exhaust their EPF lump sum within three to five years of their retirement. This over-reliance on the EPF savings for their retirement needs is further exacerbated with leakages from their EPF savings with pre-retirement withdrawals for housing, healthcare and education. The PRS would encourage the pensioner to save more in an alternate source of scheme to provide diversity of income streams.

The PRS will also alleviate the concentration risk of the retirees who have relied on one primary source for their retirement savings. The PRS will provide an alternate source of fund management expertise and one where members of the Scheme are able to freely choose between competing service providers.

A non-financial "fourth pillar"

The World Bank defines this as access to informal support such as family financial support by the younger generation, other initiatives or programmes such as universal healthcare, subsidised elderly housing/ retirement homes, home ownerships and availability of reverse mortgages.

For Malaysia, this pillar relies mainly on traditional Asian values where the young are expected to care for parents and elders.

(c) Key Players and Components

(i) <u>Employees Provident Fund (FPF)</u>

The EPF dominates the pension landscape in Malaysia. As at 31 December 2011, the EPF had a total of 13.15 million registered members of which 6.26 million are active contributors and 487,664 active employers. (www.kwsp.gov.my)

The EPF is intended to help employees primarily save for retirement by procuring a percentage of each member's monthly salary and storing it in a savings account. Employers also contribute a specific percentage to the fund to meet their legal and moral obligation to safeguard and enhance the members' retirement savings.

Age of member	Permitted withdrawal from accumulated savings
50	30% of total savings
55	100% of total savings

Legally, the EPF is only obligated to provide a yearly dividend of 2.5% on the savings left in the member's account but has historically provided a higher dividend to the members although the dividends have been declining on a trend basis because of the generally low global interest rate environment. Unlike the net asset value (NAV) for the PRS that will change every business day to reflect the latest changes in the underlying fund assets, the amount of savings in the EPF do not accrue any dividends until the dividends are declared by the EPF. Most of the EPF savings are invested in Malaysian Government Securities and other fixed income instruments (including private loans) but investments in equities is allowed. Up to 20% of the EPF assets can be invested overseas. The EPF members do have a choice of some diversification if they participate in the EPF Members Investment Scheme which allows the EPF members to invest 20% of the amount in excess of the required basic savings in Account 1 with a unit trust management company appointed by the Ministry of Finance.

The EPF is an occupational scheme and is tagged to employment under the EPF. Thus persons who are self-employed would not contribute to the EPF and would not benefit from mandatory savings for retirement. With the current 11% employee and 12% employer contributions to the EPF, an employed person saves at least 23% of their salary each month with this scheme. Effective 1 January 2012, the employer's share contribution for monthly wages of RM5,000 and below increased 1% from 12% to 13%. Further, those who are comfortable with the returns offered by the EPF (stable and higher than fixed deposits) can opt to increase their contribution per month over the mandatory rate of 11% by filling out a form with the EPF. This "extra" contribution may not be tax exempt if the total contribution amount is already above the tax relief limit.

Over time, in the absence of a viable alternative to EPF, individuals who do not fall under the EPF would experience a significant difference in their retirement savings. The PRS is introduced to encourage all target groups including the self-employed to save more so as not to be disadvantaged compared to those under the EPF although current

EPF members are also encouraged to enrol in the PRS to supplement their EPF savings if these savings in the EPF are insufficient to provide for retirement. One thing to note is that the PRS and EPF contributions are not inter-changeable. Once contributed, the amounts stay with the respective Schemes and its Scheme rules. The PRS is also suitable for any employer that wants to use it. The PRS is complementary to existing mandatory provisions. Employers can use the PRS as an opportunity to improve their recruitment appeal or employee value proposition to attract employees.

The 1Malaysia Retirement Savings Scheme is akin to the PRS in that it encourages those who are self-employed to contribute to a retirement plan but through the EPF. Once the contribution goes into the EPF, the self-employed will not have a say about the investments of their contributions as per the other EPF members.

The EPF manages the fund both internally and externally through fund managers. Unlike the PRS, the EPF members cannot select the asset class, fund manager or the mix of funds for their contribution. There is also no daily NAV calculation posted on the KWSP website because all the contributions are commingled and a dividend is declared at the end of the fiscal year. It is only then that the EPF member can assess the performance of the fund and manager.

(ii) Kumpulan Wang Persaraan (Diperbadankan) (KWAP)

The pension scheme for civil servants was established under the *Government Pension Ordinance of 1951* and applies to government personnel that were eligible as of 12 April 1991. The pension scheme is intended to provide financial security for retired civil servants by paying them a monthly pension that reflects a percentage of their last qualifying salary. The monthly pension benefit is no longer offered to any civil servants after the date but the pension liability remains for those who joined the civil service before the above date and needs to be funded. The Pensions Trust Fund was established with the aim of funding the pension liability in 1991 with a launching grant of RM500 million from the Government.

The KWAP was established on 1 March 2007 to replace the old Pensions Trust Fund and receives a minimum of 17.5% of each civil servant's salary each month as contribution from the Government towards financing its pension liability. There is no contribution at all from the individual civil servant as it is a defined benefit plan. The objective of the KWAP is to manage the fund towards achieving optimum returns on its investments and shall be applied towards assisting the Government in financing its pension liability.

(iii) Lembaga Tabung Angkatan Tentera (LTAT)

The LTAT was established in August 1972 by an Act of Parliament. The main aim of the LTAT is to provide retirement and other benefits to members of the armed forces (who are compulsory contributors) and to enable officers and mobilised members of the volunteer forces in the service to participate in a savings scheme. The secondary objective is to promote socio-economic development and to provide welfare and other benefits to retiring and retired personnel of the armed forces of Malaysia.

Under the superannuation scheme, serving members of the armed forces are required to contribute 10% of the monthly salary to the LTAT and the Government being the employer will contribute 15%.

(iv) Employer-sponsored retirement schemes

As part of a broader corporate social responsibility as well as to encourage employee loyalty, some employers have opted to provide their employees with a pension that is usually funded by employer contributions above the required EPF percentage. These plans need to be approved and fall under section 150 of the *Income Tax Act 1967* (Revised-1971). These contributions by the employers (usually tax exempt up to a certain percentage – currently up to a maximum of 19%) vest immediately but can only be enjoyed at retirement in line with the EPF savings. These schemes are usually managed in-house, have a board of trustees with specific investment and withdrawal rules and its funding is at the complete discretion of the employers. These schemes are only open to the employees of the company or group of companies. As mentioned earlier in the chapter, it is a defined benefit plan for the benefit of the employees and not a defined contribution plan like the PRS.

This employer-sponsored retirement scheme must be established through a trust deed and rules of the fund, both of which must be clearly expressed and both must also meet the strict requirements, some of which are stipulated below:

- there must be alienation of contribution to the fund i.e. the contributions made must be alienated from the contributors and be held by a third party which is the board of trustees;
- payment of the retirement benefits can only be made when the employee reaches the retirement age of 55, retires early due to illness, dies or leaves Malaysia permanently; and
- the scheme is required to follow the investment policy laid down by the IRB.

The possible losses suffered by these schemes during the recent economic crisis and the high costs of administrating such schemes have resulted in many employers opting to migrate their scheme to the EPF.

(v) Annuities

In an effort to encourage more retirement income, the public can take advantage of the tax incentives under the tax law to buy annuities offered by insurance companies. These annuities are contracts whereby the annuitant (the person who buys the annuity) receives a series of fixed payments at regular intervals (usually monthly) from the insurers until the death of the annuitant. Each annuity payment represents the repayment of a portion of the purchase price plus interest earned.

The purchase price may be done at one go (a lump sum payment) or more likely in the context of saving for retirement, paid monthly/ annually over the working tenure of a person. Contributions must continue until the price of the annuity is paid or the annuity may not provide the annuitant with the desired payment (after all, the annuity functions on the total contributions and stopped contribution disrupts the workings) at retirement. If an annuity is cancelled the annuitant may get back the contribution less administrative and other charges and the person will have to start all over again later if he wants to buy another annuity.

(vi) Conclusion

The current retirement landscape in Malaysia cannot fully address the needs of retiring Malaysians. Although the second pillar mandatory savings has provided the basis for retirement planning, solely relying on it would not be adequate to maintain a comfortable lifestyle post retirement. The traditional fourth pillar which relies on the young to care for the elderly would only work in a society where there are many to support the few. In an increasingly greying/ageing population like Malaysia, the number of elderly will increase exponentially with time and the burden on the fewer young people will be enormous. There is an impetus to find a self-sufficient solution.

Hence, there is the need to develop the third pillar of voluntary savings. The government's initiative to promote the PRS through tax incentives highlights the urgency and the importance to get the populace to think about their own retirement needs. With a national focus on more voluntary savings, the PRS is the platform to kick-start this initiative by providing a universal, flexible and tailored solution to the individual.

1.2 The objectives and benefits of the PRS

(a) The need for retirement protection

Like the rest of the world, Malaysia will also be, in the coming years, experiencing a rapidly ageing population.

	Population above 55 years of age
1980	8%
2030 (expected)	15%

	Male life expectancy	Female Life expectancy
1950s	56 years	58 years
2010	72 years	77 years
2020 (expected)	74 years	79 years

The longevity risk has posed a great challenge to the adequacy of savings for retirement. This is further compounded by premature exhaustion of retirement savings in the early period of retirement, in view of the prevailing practice of lump sum withdrawal of the EPF contributions at the age of 55 and greater demands for a lifestyle post retirement that mirrors that currently existing. This naturally necessitates an overall higher amount of savings to address this situation of funding one's lifestyle in the retirement phase.

Furthermore, there is statistical evidence to suggest that the current amount of savings under the EPF and other schemes under the mandatory "second pillar" is insufficient to last a retiree long into their retirement (with some studies showing that most run out of money within 10 years of their retirement). This is more so when the saver is wholly reliant on the EPF savings as the sole basis of retirement income and there is no alternate source of savings to supplement that income.

To address this problem, four solutions are possible.

Firstly, Malaysia is exploring whether to raise the mandatory retirement age which will allow a longer period for the employed to accumulate savings. Furthermore, with medical advances people are healthier and can work productively up to an older age.

Secondly, it can increase the mandatory contribution rate under the "second pillar". This is not ideal as it puts an unnecessary strain on employers and increases the cost of doing business and can make Malaysia uncompetitive in the effort to attract and retain talent. Furthermore, this solution is not universal as only employees who are covered under the EPF or other "second pillar" schemes would benefit.

Thirdly, it can consider raising the minimum wage over time if productivity allows so that the workers can benefit from a higher level of wages and hence savings both through the mandatory EPF and other voluntary schemes.

Lastly, it can develop a voluntary retirement scheme under the "third pillar" in order to expand the range of retirement schemes, expand coverage on a voluntary basis to all segments of the population and improve the adequacy of retirement savings overall. Having a robust multi-pillar pension system would cater to the Malaysian society's varied retirement needs and would absorb the economic, demographic and political risks faced by the pension systems. The implementation of the PRS comes under this solution.

(b) The benefits of the PRS framework

The PRS addresses the coverage issue as it helps those who do not save now under the EPF, like the self-employed. The adequacy of retirement savings is also tackled by the additional savings through the PRS Scheme. Additional or voluntary employer contributions add to the adequacy solution. Lastly, the PRS is sustainable as in terms of monthly deductions, a person need only save an additional RM250 per month to enjoy the full tax relief where a person earns a basic salary of above RM4,500.

(i) <u>PRS is a transparent investment vehicle</u>

The Scheme is generally a transparent investment vehicle where the following information is disclosed upfront:

- all fees and charges (direct and indirect);
- investment mandate including investment objectives and strategy, investment limits and asset allocation;
- fund performance; and
- publication of annual reports as well as choice of PRS Providers and PRS funds within each scheme.

Any changes to the investment objectives or fees require the approval of the PRS members while some other less material changes require a supplementary disclosure document to be lodged. The portability feature of the PRS supports transparency as members need information to make an informed decision to change PRS Providers.

(ii) <u>Provide a pool of funds to fund retirees during retirement phase</u>

This universal and inclusive effort would encourage Malaysians to save more for their retirement by becoming a self-funding retiree.

Furthermore, the PRS framework will allow individuals the flexibility to choose from various providers and funds offered. The PRS is portable whereby contributions made and accrued to the PRS members can be transferred to another provider. The portability feature (which we will discuss under Chapter 4 Features of the PRS) also encourages good performance that will benefit the PRS participant. Over the long term, this should result in better long-term returns and a higher amount of savings available at retirement, provided investments in the fund performs as expected.

If the retiree managed to build up sufficient savings (both through contribution and investment performance) in the PRS during the employment/savings phase of the retiree, then the yearly returns of the PRS during the retirement phase will enable the retiree to supplement a portion of the living expenses during retirement. Coupled with a drawdown in accumulated wealth (the EPF savings) and other incomes (e.g. allowance from children, interest from savings), the retiree will be able to live a comfortable lifestyle.

(iii) <u>Additional source of long-term capital for economic growth</u>

While maintaining the primary aim of increasing retirement savings for individuals so as to fund their retirement needs during old age, the PRS has ancillary benefits of unlocking savings as Malaysians have a high savings rate by international standards. This unlocked savings could be channelled to create new and sustainable fund flow to spur economic growth and growth in the capital markets in particular. This helps the member directly as robust growth in the capital markets may attract talented fund managers who will manage the PRS effectively to help the member achieve his long-term return goals. The strong growth in the financial sector will also not be isolated and will spill over to other sectors thereby increasing wage levels and quality of life. When the members help the capital markets, they actually help themselves in a virtuous cycle.

(iv) <u>Benefits to the Malaysian capital market</u>

These sustained fund flows from the PRS will increase vibrancy in the capital markets and yield benefits, including:

- increased product innovation and competition;
- increased activities and skill sets of the intermediaries;
- building scale in the fund management industry.

(v) Reduce the burden on Government finances

A vibrant PRS and other "third pillar" schemes guided by the World Bank's multi-pillar approach would reduce the need for the Government to provide a social safety net for the population in retirement phase.

(c) "Third pillar" experiences in other countries

The PRS is an example of the "third pillar" under the World Bank's framework. This third pillar scheme helps the members to voluntarily save more for their own retirement needs. The implemention of "third pillar" schemes is varied but generally the issues of an ageing population and sustainable retirement, need to be addressed promptly and many governments around the world are doing just that.

Some of the examples of implemented schemes are:

KiwiSaver in New Zealand

This scheme started out as a voluntary long-term savings scheme and came about in July 2007. It is aimed at improving the low average rate of saving. Employee participants can chose to contribute 2%, 4% or 8% of their gross pay with a lot of flexibility to change contribution rates or scheme providers. The self-employed can choose how much they want to contribute. There are some tax benefits to the scheme to encourage participation. There were 1.6 million KiwiSavers as at June 2011 with total contribution of NZ$1.6 billion.

Supplementary retirement scheme in Singapore

The supplementary retirement scheme (SRS) is part of the Singapore government's multi-prong strategy to address the financial needs of a greying population. Contributions to the SRS are voluntary and are eligible for tax relief. Investment returns are accumulated tax-free and only 50% of the withdrawals from the SRS are taxable at retirement. The annual SRS contribution cap (currently at S$12,750 for Singaporeans and permanent residents and S$29,750 for foreigners) is subject to review. As at 31 December 2010, the total SRS contributions amounted to S$2.49 billion.

PRACTICE QUESTIONS

Question 1

In the context of the World Bank Pension Conceptual Framework, the Private Retirement Scheme would fall under the ____________________.

(A) "first pillar"

(B) "second pillar"

(C) "third pillar"

(D) "fourth pillar"

[Answer: C]

Question 2

What are some of the cited benefits from the Private Retirement Scheme?

(i) Reduce the need for Malaysians to invest in unit trusts

(ii) Additional source of long term capital for economic growth

(iii) Improve the living standards of Malaysians at their retirement

(iv) Increase the fiscal burden of the Government to provide a social safety net

(A) (i) and (iv) only

(B) (i) and (iii) only

(C) (ii) and (iii) only

(D) (ii), (iii) and (iv) only

[Answer: C]

Question 3

Which of the following statements are TRUE in relation to the Private Retirement Scheme?

(i) It is mandated by law

(ii) It is a voluntary pension scheme

(iii) It is a defined benefit plan

(iv) It is a defined contribution plan

(A) (i) and (iii) only

(B) (i) and (iv) only

(C) (ii) and (iii) only

(D) (ii) and (iv) only

[Answer: D]

CHAPTER 2

REGULATORY FRAMEWORK

Learning objectives

The Securities Commission Malaysia (SC) has developed the regulatory and supervisory framework for the PRS industry. The overall design of the regulatory framework, which includes the relevant legislation, regulations and guidelines, is in line with best practices and will build confidence in the PRS industry.

Under the regulatory framework set out under the *Capital Markets & Services Act 2007* (CMSA), the SC is empowered to regulate, approve and supervise the following components of the PRS industry:

- PRS Administrator;
- PRS Providers;
- The Scheme;
- Trustee to the PRS (Scheme Trustee); and
- Trustee to the employer-sponsored retirement schemes (Employer Trustee).

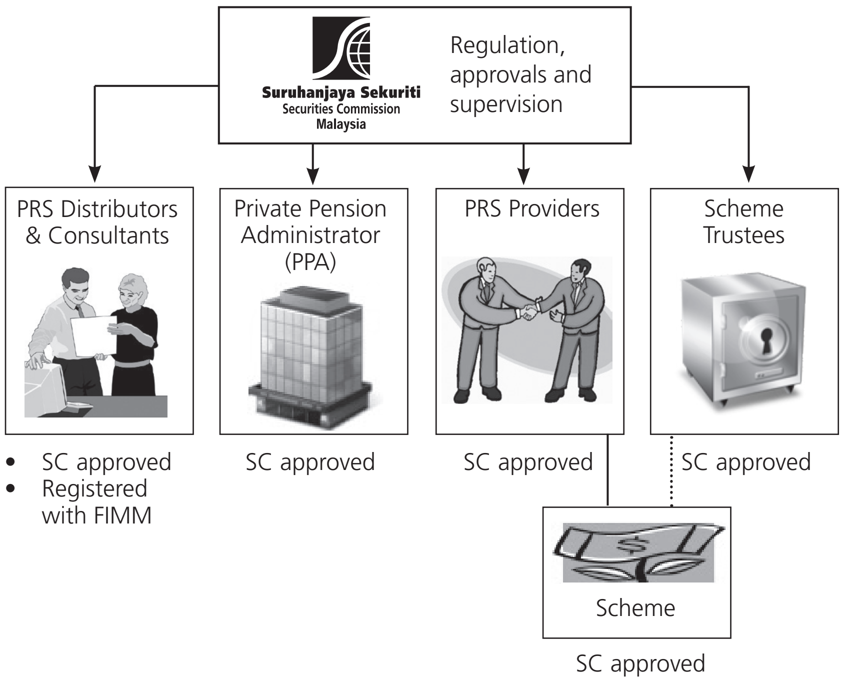
At the end of this chapter, you should be able to–

- describe the regulatory framework of the PRS industry;
- list the different legislation, regulations and guidelines governing the PRS industry;
- describe the role of the SC in the PRS industry;
- describe the role of the PRS Providers, the PRS Distributors and Consultants, and the private pension administrator (PPA) in the framework;
- recognise the need for the PPA to maintain security and confidentiality of information;
- recall the penalty for failure to perform the duty to maintain the confidentiality of member information; and
- list the functions of the PPA.

2.1 Introduction

The introduction of the PRS framework resulted from recommendations made by the SC to the Government to accelerate the development of the private pension industry in Malaysia.

It was recognised that a robust PRS industry needed to be underpinned by a strong regulatory structure. The objective of regulation is to ensure the proper functioning of the PRS industry that promotes system stability and protects members and beneficiaries, via prudential and investor protection requirements. To achieve this aim, the SC has put in place duties and responsibilities with adequate powers and resources to regulate, supervise and enforce regulations over the PRS industry.



2.2 Role of the Securities Commission Malaysia over the PRS industry

(a) General

The SC is empowered by law to regulate and supervise the PRS industry, which includes the Scheme, PRS Providers, PRS Distributors and Consultants, Scheme Trustees, Employer Trustees and PRS Administrator to be known as the Private Pension Administrator.

In this respect, the CMSA, the PRS Regulations and the PRS Guidelines are aimed at providing a regulatory environment that protects the security of the savings within the PRS framework and safeguard the interest of the contributors to the PRS. The SC may take enforcement action under the securities laws for any contravention of these guidelines.

(b) Develop the private pension industry

Given the responsibility entrusted by the Government, the SC develops the PRS as an integral part of the private pension landscape in Malaysia to–

(i) provide a well regulated and supervised PRS industry;

(ii) provide choice and flexibility to the members in their effort to save for retirement;

(iii) build trust and confidence in the PRS industry and its framework;

(iv) facilitate a cost effective private pensions framework; and

(v) safeguard the interests of the members through prudent operational guidelines.

2.3 Legislation, regulations and relevant guidelines

As of 5 April 2012, the regulatory framework of the PRS industry is set out in the following:

- *Capital Markets & Services Act 2007* (CMSA);
- *Capital Markets and Services (Private Retirement Scheme Industry) Regulations 2012* (PRS Regulations); and
- New guidelines issued by the SC, which include:
  - *Eligibility Requirements for PRS Providers*; and
  - *Guidelines on Private Retirement Schemes* (PRS Guidelines).

The regulatory framework developed by the SC aims at ensuring that the PRS industry operates in a safe and secure environment where the general public have full confidence to voluntarily contribute and save for their retirement needs.

(a) Capital Markets & Services Act 2007 (CMSA)

The CMSA stipulates the legislative requirements for the PRS Providers, PRS, Scheme Trustees, Employer Trustees and PRS Administrator. The PPA is intended to perform the duties and functions of an approved PRS Administrator as set out in the CMSA.

The SC's powers and authority as regulator of the PRS industry are clearly set out in the recent amendments to the CMSA. These amendments which came into operation on 3 October 2011 introduced the new Part IIIA that sets out the relevant legal provisions on the PRS industry. The provisions under the CMSA are divided as follows:

(i) Division 1 entitled Preliminary;

(ii) Division 2 on the PRS which includes subdivisions on private retirement scheme administrator, PRS Providers, PRS and Scheme Trustees;

(iii) Division 3 on Trustee for employer-sponsored retirement schemes; and

(iv) Division 4 entitled General.

Some of the requirements that are provided for are as follows:

(i) Monies received from members are kept in a trust account;

(ii) Vesting of contributions made by members as accrued benefits which members are entitled to; and

(iii) Preservation of accrued benefits for its members.

(b) PRS Regulations

The regulatory framework set out in the CMSA empowers the SC, with the approval of the Minister to make regulations on all matters relating to the PRS, private retirement scheme administrator, PRS Providers, the Scheme Trustees and the Employer Trustees. The regulations may also prescribe standards and conducts of the approved participants involved in this new industry.

The PRS Regulations which came into operation on 19 March 2012 seek to supplement the operationalisation of the new Part IIIA on the PRS industry in the CMSA. Key provisions in the PRS Regulations include–

(i) Requirements for the registration, lodgement of deed, disclosure document and Products Highlights Sheet;

(ii) Duties and responsibilities of the PRS Provider, Scheme Trustee and Employer Trustee;

(iii) Indemnity and replacement of a Scheme Trustee;

(iv) The powers of the court in specific instances; and

(v) Requirements relating to maintaining register of members, rights with regard to deceased members, meeting of members and prior approval of the SC for winding up of a Scheme.

(c) Eligibility requirements

The primary criteria in assessing the application for approval as a PRS Provider are based on compliance with the *Eligibility Requirements for Private Retirement Scheme Providers* (Eligibility Guidelines). The Eligibility Guidelines set out the expectation and requirements that must be satisfied by an applicant. The promotion of high governance was evidenced by the stringent eligibility requirements (e.g. relevant expertise in the management of funds and good track record) and operating requirements (e.g. capital, investment limits, governance and risk management) required of a PRS Provider under the Eligibility Guidelines.

In this respect, applicants also need to outline their business model for offering the PRS including the proposed range of funds, indicative fees and charges structure, as well as their ability to meet the specific administrative requirements of the PRS, such as resourcing capabilities, systems and process capabilities, and member servicing. Qualitative factors such as governance structure, reputation and professional standing, as well as track record and the commitment to grow the PRS industry have also been taken into consideration.

(d) PRS Guidelines

The PRS Guidelines are issued by the SC pursuant to section 377 of the CMSA and it stipulates the operational requirements for the PRS, PRS Providers and Scheme Trustees. The PRS Guidelines further clarify in detail, the requirements to be complied with by the PRS Providers in establishing, offering a Scheme or presenting themselves as establishing, offering or providing a Scheme as well as requirements to be complied with by a Scheme Trustee. The PRS Guidelines are aimed at providing a regulatory environment that will protect the security of the savings within the PRS framework and safeguard the interest of contributors to the Scheme.

The SC is given the power under section 92A(1) of the CMSA to specify the information to be given to a person who makes a contribution to a PRS. Regulation 7 of the PRS Regulations further provides that, a person shall not issue, circulate or distribute any form of application for contribution to a PRS without registering and lodging a disclosure document with the SC containing information as set out in the PRS Guidelines.

(e) Other applicable guidelines

Where a PRS Provider carries on any regulated activity specified in Schedule 2 of the CMSA, the PRS Provider must be a holder of a Capital Markets Services

Licence to carry on the regulated activity of fund management, and must observe and comply with the relevant guidelines issued by the SC for licence holders, including–

(i) *SC Licensing Handbook*; and

(ii) *Guidelines on Compliance Function for Fund Management Companies.*

A PRS Provider may outsource its back office functions to external parties. In this regard, a PRS Provider must observe and ensure compliance with the requirements in the *Guidelines on Outsourcing for Capital Market Intermediaries* issued by the SC.

2.4 Key components of the framework

(a) PRS Providers

Under section 139P of the CMSA, only approved PRS Providers will be allowed to offer PRS (and retirement funds under the Schemes) to the general public. Section 139Q of the CMSA provides that applications for approval as a PRS Provider may be made in such manner and form as may be specified by the SC. In approving the application, the SC may impose conditions or restrictions as it deems fit (section 139Q(3) of the CMSA).

To qualify as a PRS Provider, the applicant, among other things, must hold or apply to hold a Capital Markets Services Licence for the regulated activity of fund management.

The PRS Providers are approved by the SC to establish or provide a PRS and offering the Scheme to the investing public including employers. The PRS Provider will manage and administer the funds under the Schemes according to the deed and disclosure documents. The PRS Provider owes a duty of care to the members of the PRS to observe high standards of integrity and fair dealing in administering the PRS and managing the funds to the best interest of the members of the Scheme.

The PRS Regulations also provide certainty and crystallise the main role of the PRS Providers. Key duties of the PRS Provider under Regulation 10 include:

(i) Exercise the PRS Provider’s powers for a proper purpose and in good faith, in the best interest of the members as a whole;

(ii) Exercise the degree of care and diligence that a reasonable man would exercise if he was in the PRS Provider’s position;

(iii) Perform the function of the PRS Provider and the management and operation of the PRS in accordance with the CMSA, the PRS Regulations, and any guidelines issued by the SC and the deed;

(iv) Give priority to the interest of members in the event of a conflict;

(v) Keep complete and accurate records of all information and make available such records to the Scheme Trustee and auditors, as well as the deed to the public;

(vi) Not act as principal in the sale and purchase of securities, property and assets to and from the PRS unless specified otherwise by the SC; and

(vii) Not make investments in which it could have a financial interest or derive a benefit without approval of the Scheme Trustee.

The main thrust of its duties is the proper and efficacious operation of the Scheme, run in the interests of its members. The PRS Provider performs a central function in terms of receiving contributions, processing transactions by members and managing the funds within the Scheme.

A further duty imposed via Regulation 11 is on the duty of the PRS Provider to prepare and send the annual report of the PRS to the SC and all members. The regulation also provides the time frame within which such annual report must be sent to members and that it must be provided without charge to members. PRS Providers are only permitted to charge a reasonable sum for additional copies requested by members.

(b) PRS Distributors and Consultants

The PRS Distributors would be licensed for the new regulated activity of dealing in PRS under Schedule 2 of the CMSA or fall within the types of registered persons under Schedule 4 of the CMSA. Representatives of the PRS Distributors to be termed as PRS Consultants must be registered with the Federation of Investment Managers Malaysia (FIMM).

The underlying principle is to ensure all PRS Consultants obtain a minimum standard of knowledge of the PRS industry. The PRS Consultants meet potential members and employers and are often the first point of contact for the members. The PRS Consultants owe a duty of care to the members and potential members of the PRS to act with integrity and with a high level of professionalism. The duties of the PRS Consultants are listed out in Chapter 7 of this study guide and these include–

(i) acting with honesty, integrity and dignity and conducting themselves in a professional and ethical manner;

(ii) treating members with respect and disclosing fully, all information pertinent for members to make informed investment decisions; and

(iii) not misrepresenting the PRS, funds or past performances of the funds in the marketing of the PRS.

(c) Private Pension Administrator

The establishment of the PPA is a critical component in the private pension landscape to enhance the efficiency and convenience to members as well as overall administration of an effective PRS industry. The PPA will be responsible for ensuring the establishment and operationalisation of an efficient administrative system for the overall private pension industry in Malaysia. Overall, it will be responsible for facilitating and maintaining all PRS related transactions made by contributors and members. The PPA will also function as a resource centre for data and research relating to the PRS industry in Malaysia.

(i) Duties and responsibilities

The PPA is an entity approved by the SC to perform the function of record keeping, administration and customer service for the members and contributors in relation to contributions made in respect to the PRS.

Some of the specific duties are–

- receiving and transmitting instruction in a manner specified by the SC;
- keeping records of all transaction or monies paid or received;
- providing information to the PRS Provider and member; and
- such duties as may be specified by the SC.

The PPA must act in the public interest at all times particularly taking into considerations the needs for protection of the members. The PPA must immediately notify the SC if there are adverse circumstances likely to affect the members. The PPA should also not impose fees or vary charges on a PRS Provider or member without the prior approval of the SC. Its terms of reference or operating rules also require prior approval of the SC.

Other duties of the PPA include undertaking general promotion and awareness of the PRS and to act as a resource centre for data and research for the PRS industry. The PPA would also monitor fees charged and performance offered by the different PRS Providers.

None of the duties and responsibilities of the PPA can be delegated or outsourced without the approval of the SC.

(ii) Prior approval for directors and CEO and board composition

Directors and the CEO of the PPA must be approved by the SC.

The board of directors must comprise of at least one-third public interest directors.

(iii) <u>Need to maintain security and confidentiality of information</u>

- Duty to take reasonable security measures

  The PPA should take all reasonable measures to protect the information and documents relating to the members against any unauthorised access, alteration, disclosure and dissemination. The PPA must put in place the necessary administrative infrastructure and security measures to perform this duty.

- Duty to maintain secrecy

  The PPA will have access to sensitive and personal information and documents relating to the members of the PRS. The PPA is duty bound not to divulge such information to any person unless under specifically expressed circumstance provided for under section 139N and 139O of the CMSA.

  This duty is very important and the person who fails in this duty can be liable to a fine not exceeding three million ringgit or to imprisonment for a term up to five years or both. This is to reassure the public that privacy of their data is paramount.

(iv) <u>Functions of the PPA</u>

In performing its functions, the PPA will undertake the following:

- Receive registration information from PRS Providers and issue a lifetime private pension account number to members;
- Maintain databases of all private pension account numbers issued and transactions relating to each member's account;
- Transmit members' instructions to update account details, transfer between PRS Providers and withdraw monies;
- Issue consolidated account statements to all members;
- Maintain a website providing members with online access to their accounts, detailing the Scheme offered by each PRS Provider and general education/awareness;
- Operate a call centre and deal with complaints; and
- Generate reports, including statistical and compliance reports, on developments in the PRS industry.

(v) Private pension account

A life-time private pension account will be opened for the potential member by the PPA by completing the required opening form, payment of a small fee and providing proof of identification. The account opening procedure may vary for online transactions.

After the account is opened, the PPA will send the member a letter or an email containing a unique username and password to access their account online at www.ppa.my.

The private pension account will reflect all the contributions made by the member or employer as contributor to all PRS Providers. In addition, each PRS Provider will also maintain an account for each member of its Schemes.

The PPA will send members consolidated statements of all their holdings whereas each PRS Provider will send statements of accounts to members subscribed to their Schemes.

(vi) Fees and charges involved

All PRS Providers will charge the member fees for investment management, trustee and administrative costs. The disclosure document will set out the fees they charge. Each member will have to refer to their respective PRS Provider for a complete list of fees/charges involved.

The PPA would also charge fees for opening, facilitating transactions and maintaining the PPA account for each member. The PPA website will detail the main fees and charges by each PRS Provider for easy comparison. Any fees to be charged by the PPA to members or contributors may be collected by the PRS Provider acting on behalf of the PPA.

(vii) Keeping track of their PRS investments

Members can check their PRS investments online with the PPA or contact their respective PRS Providers. Members will receive statements on a periodic basis from PRS Providers and consolidated statements on the investments, including contributions held by every PRS Provider from the PPA.

PRACTICE QUESTIONS

Question 1

The following are the duties of the Private Pension Administrator, EXCEPT:

(A) undertake general promotion and awareness of the Scheme

(B) act as a resource centre for data and research for the PRS industry

(C) monitor fees charged and performance offered by the different PRS Providers

(D) appoint the Scheme Trustee for each Scheme

[Answer: D]

Question 2

Which of the following requires the approval from the Securities Commission Malaysia?

(i) PRS Providers

(ii) The Private Retirement Schemes

(iii) PRS Consultants

(iv) Scheme Trustees

(A) (iii) only

(B) (i) and (ii) only

(C) (i), (ii) and (iv) only

(D) All of the above

[Answer: C]

Question 3

Which of the following are legislation, regulations and guidelines relevant to the Private Retirement Schemes?

(i) Capital Markets & Services Act 2007

(ii) Capital Markets & Services (Private Retirement Scheme Industry) Regulations 2012

(iii) Guidelines on Private Retirement Schemes

(iv) Eligibility Requirements for Private Retirement Scheme Providers

(A) (i) only

(B) (i) and (ii) only

(C) (ii), (iii) and (iv) only

(D) All of the above

[Answer: D]

CHAPTER 3

THE PRIVATE RETIREMENT SCHEME PROVIDER

Learning objectives

Only PRS Providers who have been approved by the SC can establish, offer or provide a PRS or hold themselves out as establishing, offering or providing a PRS.

At the end of this chapter, you should be able to:

- list the eligibility and selection criteria for a PRS Provider;
- describe in detail the duties and responsibilities of a PRS Provider;
- list the key personnel of a PRS Provider and their roles; and
- explain the operational procedures with regard to–
  - the register of members;
  - the "cooling-off right";
  - any conflict of interest;
  - rebates and soft commissions;
  - inspection by members;
  - meeting of members;
  - investment committee;
  - audit committee;
  - Shariah adviser; and
  - panel of advisers.

3.1 Approval

The PRS Provider must be approved by the SC.

(a) Eligibility criteria

To qualify as a PRS Provider, one must–

(i) be an existing financial intermediary or parent or holding corporation of an existing financial intermediary;

(ii) have relevant experience in operating and administering retail or pension funds or life insurance business;

(iii) meet the minimum paid-up capital of RM5 million and the shareholders' fund requirements of RM20 million which is to be maintained at all times;

(iv) have good corporate governance in terms of clear lines of reporting, responsibility and authority within the organisational structure, with the board of directors of the PRS Providers being fit and proper persons with relevant skills, experience and competence to perform their roles in the company; and

(v) establish a comprehensive compliance and risk management system including an internal audit framework, a risk management framework, a compliance framework and a business continuity plan.

Additionally, the PRS Provider with current business operations must show that there are adequate policies to manage any conflict of interest between the PRS business and its current operations.

(b) Selection criteria

(i) Track record

A strong track record in the fund management industry is an essential selection criterion. The PRS Provider can demonstrate this by–

- having relevant experience in fund management, pension fund management or life insurance investment;

- having assets under management of RM1 billion (or equivalent in foreign currency) annually within the last three consecutive years; and

- having key personnel with at least three years in the relevant investments in the proposed funds in the scheme and ten years of fund management experience in a related industry.

(ii) Administrative capabilities

The PRS Provider will be required to have effective administrative systems. The PRS Provider must demonstrate the ability to–

- handle large volumes of transactions;
- administer small and inactive account balances;
- interface with the PPA and the other PRS Providers' systems to accommodate the members investment requests;
- handle and resolve complaints;
- ensure confidentiality; and
- produce reports to the members, Scheme Trustees, the PPA and the SC.

3.2 Duties and responsibilities

In addition to the duties and responsibilities under Regulation 10, PRS Providers are required to comply with the requirements under the PRS Guidelines and other applicable guidelines.

(a) General

(i) Operation of the Scheme

A PRS Provider must operate the PRS, manage the funds under the PRS and exercise its responsibilities according to the–

- deed and disclosure document;
- PRS Guidelines;
- securities laws including the PRS Regulations; and
- best business practices observed within the investment management industry.

A PRS Provider must–

- observe high standards of integrity and fair dealing in administering the PRS and managing the funds to the best interest of the members;
- ensure that the fund's property be clearly identified and segregated from the other properties of the PRS Provider; and

- comply with any other duties conferred on the PRS Provider by the deed so long as it is not in contravention of existing laws and regulations.

(ii) A strong organisation structure

To ensure that the PRS Provider will be adequately equipped to undertake the business of managing the Scheme in a proper and efficient manner, the PRS Provider must build a strong organisational structure. The organisational structure should have–

- clear lines of responsibility, authority and reporting;
- strong risk management and control systems;
- adequate and qualified human resources; and
- adequate and appropriate systems, procedures and processes.

(iii) Accountability to the Scheme Trustee

A PRS Provider will have to account to the Scheme Trustee for any loss suffered by the fund as a result of inadequate care and diligence required in operating the Scheme and managing the funds under the Scheme.

(iv) Compliance by PRS Providers' officers and delegates

A PRS Provider must ensure that its officers and delegates–

- do not make use of information acquired in the process of fulfilling their roles to gain an advantage for themselves or to cause detriment to the members of the PRS;
- do not abuse their position to gain an advantage for themselves or to cause detriment to the members of the PRS; and
- comply with any duties and obligations prescribed by the securities law, trust laws and the PRS Guidelines.

(b) Duties to the PPA

The PPA is established to act as the central repository of information and data of members of the Schemes as well as to enhance the overall administrative efficiency in the PRS industry.

To enable the PPA to perform its duties and responsibilities under section 139H of the CMSA, a PRS Provider must–

- provide information and comply with reporting requirements, in such manner and frequency as stipulated by the PPA;
- notify PPA in a timely manner of any changes made to Schemes or funds under the Scheme or disclosure document;
- facilitate the opening of a private pension account including scanning and uploading of the relevant forms and information; and
- take all steps to comply with the instructions given by PPA in respect of a member's request made to the PPA to –
  - make any pre-retirement withdrawal from any fund under the PRS; or;
  - transfer monies to another PRS Provider

(c) Accurate valuation and pricing

The PRS Provider must take reasonable safe guards to ensure that all the funds under the Scheme as well as each fund unit is correctly valued and priced and not omit anything in the pricing that would benefit the PRS Provider to the detriment of the PRS member.

(d) Transaction at arm's length

The PRS Provider must conduct all transactions for a fund at arm's length (as if all parties are independent and on an equal footing) and ensure that it would not conduct transactions that would result in unnecessary costs or risk to the fund.

(e) Adequate accounting and other relevant records

The PRS Provider must maintain adequate records–

- to enable a complete and accurate view of the Scheme and its funds;
- to comply with the deed, the PRS Guidelines, securities and other relevant law; and
- to ensure that the financial statements of the Scheme and its funds give a true and fair view of the financial positions in accordance with approved accounting standards of each fund's positions at the end of a financial period.

(f) Holding of units by the PRS Provider

A PRS Provider or its nominees must not hold any units in a fund under the Scheme, other than when complying with repurchase requests by members or creating new units to meet anticipated requests for units from contributors subject to a maximum of–

- three million units per fund; or
- 10% of the units in circulations of the fund, whichever is lower.

(g) Complaints handling

A PRS Provider must establish, maintain and implement written policies and procedures to ensure that complaints from members are handled in a timely and appropriate manner, and to ensure that these complaints are satisfactorily resolved. A register of complaints received and any action taken must be maintained by the PRS Provider.

3.3 Board of directors and key personnel

(a) Board composition

The board of directors of a PRS Provider must comprise at least two independent members and must maintain a minimum ratio of at least one-third independent members at all times. The duties of the independent directors are to safeguard the interest of the PRS members.

(b) Key personnel

(i) <u>Chief executive officer</u>

The chief executive officer of the PRS Provider must be a full-time officer.

(ii) <u>Designated person responsible for the fund management function</u>

The PRS Provider must appoint an individual to be responsible for the fund management function of each fund under the Scheme and this individual can be responsible for more than one fund.

(iii) <u>Compliance officer</u>

The compliance officer ensures compliance with the deed, PRS disclosure document, the PRS Guidelines and securities laws, by reporting his findings to the board of directors and where established, the compliance committee. If the PRS Provider administers a fund in accordance to Shariah principles, the compliance officer must be conversant with Shariah laws and principles.

The duties of the compliance officer are set out in the Guidelines on Compliance Function for Fund Management Companies. In addition, the compliance officer is tasked to–

– monitor and resolve conflict of interest situations;

– examine and investigate irregularities in the PRS Provider's operations;

– be responsible for the compliance manual and the code of conduct for employees of the PRS Provider;

– advise on compliance matters and regulatory developments; and

– be responsible for compliance training in the PRS Provider.

(iv) <u>Internal audit function</u>

A PRS Provider must maintain an independent internal audit function to report to the audit committee on the adequacy, efficiency and effectiveness of the risk management and internal controls of the PRS Provider.

3.4 Operational matters

(a) Register of members

A PRS Provider must keep an up-to-date register of members at the registered office or principal place of business and ensure the following information required under regulation 17 of the PRS Regulations are included:

- The name, address and identity card number of the members;
- The number of units held by each member in each fund under the Scheme;
- The date on which each member was entered into the register;
- The date on which any person ceases to be a member; and
- Any other information as required by the SC.

In addition to Regulation 17, a PRS Provider must enter into the register:

- the member's passport number for members that are foreigners;
- where the PRS Provider holds units of funds in the Scheme, the corporation's name and registration number; and
- where units are issued pursuant to a vesting schedule, the name of the employee as member and further classify such units as vested or conditionally vested in accordance with the vesting schedule.

A PRS Provider must also–

- alter the register upon receiving a written notice of a change of name or address of any member; and
- refuse to make entries into the register in joint names.

In the event of conflict or discrepancy, the entries in the register of members as maintained by the PRS Provider shall prevail over the information in the private pension account maintained by the PPA.

A PRS Provider may, on giving not less than 14 days' notice to the SC, close the register but no part of the register should be closed for more than 30 days in any calendar year. Any members aggrieved by such an action have a legal recourse to rectify the register.

(b) Cooling-off right

A cooling-off right must be given to a member who contributes to a PRS for the first time. Once an individual is a member of a PRS and has exercised his cooling-off right, the cooling-off right is not available with regard to contributions in other Schemes.

This will provide the member (other than staff of the PRS and any other person approved to deal in the PRS) the opportunity to reconsider the decision to participate in the PRS. The cooling-off right period must not be fewer than six business days commencing from the date of the receipt of the PRS application by the PRS Provider. The refund for the exercise of this cooling-off right would be the purchase price of the units and any charges imposed with purchase. All monies would be returned to the member as if the person never contributed to the PRS in the first place.

(c) Conflict of interest

A PRS Provider and others involved in the running of the PRS like the Scheme Trustee, delegates and service providers must avoid conflicts of interest wherever possible. If conflicts are unavoidable, then a PRS Provider must ensure that the conflict does not result in any disadvantages to the PRS member, that is all transactions with the related parties must be transacted on an arm's length basis as if they are independent parties. The independent directors of the PRS Provider have to approve the appointment and renewal of these related parties.

(d) Rebates and soft commissions

Soft commissions are goods and services (e.g. research and news services) provided by brokers/dealers but not paid for in actual dollars but by trading commissions generated from fund activities. Rebates are a return of the trading commissions back to the PRS Provider based on some measure (for example, volume rebates).

Rebates must be redirected to the specific fund concerned. However, goods and services from soft commissions may be retained by the PRS Provider if it can be demonstrated that the goods and services benefit members and–

- the dealings are done on the best available terms; and
- the soft commission practices are disclosed in the disclosure document and the fund report.

The compliance officer must verify and inform the PRS Provider's board of directors or audit committee or compliance committee that the goods and services received by the PRS Provider indeed comply with the requirements.

(e) Inspection by members

All PRS members have a right to inspect documents that relate to their PRS. Thus the PRS Provider and the Scheme Trustee must make available at their principal place of business these documents:

- The deed and any supplementary deed of the PRS;
- The current disclosure document and supplementary disclosure document of the PRS (if any);
- The latest annual and interim reports of the various funds of the PRS;
- Each material contract and document referenced by the disclosure document and supplementary disclosure document;

- All other documents referred to in the disclosure documents and supplementary disclosure documents including reports, letters, valuations and statements by any experts;

- The audited accounts of the PRS Provider and the funds under the Scheme for the last three years or from the date of incorporation or commencement (if less than three years);

- Latest audited account of the PRS Provider and the funds under the Scheme for the current financial year; and

- any consents given by experts or persons named in the disclosure document or supplementary disclosure documents as having made a statement that is included in the disclosure documents of supplementary documents;

for inspection by members at all time and without charge or a fee during the ordinary business hours of the PRS Providers and the Scheme Trustees.

(f) Meeting of members

(i) Meetings called by the PRS Provider or Scheme Trustee

A PRS Provider or a Scheme Trustee may call for a meeting of the PRS or fund under the Scheme at any time by–

- giving at least 14 days' written notice to members;

- specifying in the notice, the venue and time as well as the resolutions being proposed; and

- publishing the notice of the said meeting in the local newspaper.

(ii) Meeting requisitioned by members

Members of a PRS may also requisite the PRS Provider to call for a meeting under the provisions of Regulation 20 of the PRS Regulations if the following are met:

- Not less than fifty members or one-tenth of all members of the Scheme or the fund as the case may be, direct the PRS Provider to do so in writing;

- The written direction is given to the PRS Provider at its registered office; and

- The purpose of the meeting is to consider the most recent financial statement; to give the Scheme Trustee such directions as the meeting deems proper; or to consider any other matter in relation to the Scheme or the fund or the deed.

Under such circumstances, the PRS Provider would need to call for a meeting within 21 days after receiving the request from the members and give written notice to all members of such a meeting by writing to their last known address. Notice must also be given by publishing an advertisement in a national language national daily and one other newspaper approved by the SC.

(g) Investment committee

(i) Part of the oversight function in a PRS

In addition to the Scheme Trustee, the investment committee is formed as part of the oversight function in a PRS that will give added comfort to the members that the investment elements of the funds under a Scheme are properly maintained and adhere to the objectives and limitations of the deed and other disclosure documents.

(ii) Composition

An investment committee of a fund must comprise at least three individual members and a minimum ratio of at least one-third independent members with at least two independent members at all times.

An individual can be appointed to be in more than one investment committee of a PRS but he should not hold office in the following due to a conflict of interest:

- As a member of an investment committee in fund administered by another PRS Provider or management company outside the group of companies;
- As a director of another PRS Provider or management company outside the group of companies;
- As a Shariah adviser of the same fund;
- A member of the panel of adviser of the same fund; and
- As an officer of the delegate that carries on the fund management function of the same fund.

The PRS Provider must ensure that the individuals appointed to the investment committee are "fit and proper" as defined by the PRS Guidelines and have the requisite fund management expertise to carry out their roles and responsibilities.

(iii) Roles and responsibilities

An investment committee's roles and responsibilities include the following:

- Select strategies appropriate for achieving the fund's objective;
- Ensure the strategies are properly and efficiently implemented; and
- Actively monitor, measure and evaluate the performance of the fund.

(h) Audit committee

(i) Composition

The audit committee must comprise non-executive members of the PRS Provider with at least three individual members and a minimum ratio of at least one-third independent members with at least two independent members at all times. A member of an audit committee must not hold office as–

- Shariah adviser for any fund of the PRS Provider;
- a member of the panel of advisers for any fund of the PRS Provider; and
- an officer of the delegate that carries on the fund management function for any fund of the PRS Provider.

(ii) Roles and responsibilities

Similar to the investment committee and the Scheme Trustees, the audit committee helps in the oversight function of the fund by reviewing and reporting to the board of directors on the internal audit framework and function, and ensuring that matters highlighted by the audit report have been satisfactorily resolved. The audit committee also reviews the interim and annual report of the PRS Provider as well as any related-party transaction and conflict-of-interest situation that may arise.

(i) Shariah adviser

(i) Composition

A Shariah adviser must be independent of the PRS Provider and be registered with the SC. Where individuals are appointed, a Shariah adviser must comprise at least three individuals who meet the "fit and proper" criteria. Where a corporation is appointed as an adviser, the said corporation must engage at least one Shariah expert who meets the "fit and proper" criteria. "Fit and proper" criteria includes having a good reputation and character, possessing high standards of integrity, fair dealings with everyone, taking reasonable care in carrying out the duties, and possessing the necessary qualifications, expertise and experience to perform duties.

(ii) Roles and responsibilities

The principal role of the Shariah adviser is to ensure that all aspects of the PRS and fund management business including the fund structure and investment as well as documents like the deed and disclosure documents are compliant with Shariah principles. The adviser would need to prepare a report to be included in the PRS' annual and interim reports stating whether the Shariah-compliant fund has been operated and managed in accordance with the Shariah principles for the financial period in question.

(j) Panel of advisers

(i) General

When a fund adheres to a specific set of principles (for example socially responsible investment), then a panel of advisers must be appointed. This panel must comprise at least three individuals who are independent from the PRS Provider and must meet the "fit and proper" criteria.

(ii) Roles and responsibilities

The panel of advisers have a responsibility to ensure that the fund is managed according to the specific principles of the fund by reviewing the fund's compliance report and the investment transaction report. The panel of advisers must also prepare a report to be included in the PRS annual and interim reports stating their opinion on whether the investment principles have been adhered to.

PRACTICE QUESTIONS

Question 1

The following are the duties of the PRS Provider EXCEPT:

(A) operate the fund according to the deed

(B) hold the fund's assets in trust on behalf of the members

(C) build an organisational structure with clear lines of responsibility, authority and reporting

(D) ensure the fund's properties are identified and segregated from the other properties of the PRS Provider

[Answer: B]

Question 2

The cooling-off right period must not be less than __________ business days starting from the date of the receipt of the PRS application by the PRS Provider.

(A) five

(B) six

(C) seven

(D) ten

[Answer: B]

Question 3

Which of the following parties form part of the oversight function in a Private Retirement Schemes?

(i) Scheme Trustee

(ii) Audit committee

(iii) Investment committee

(iv) PRS Consultant

(A) (i) and (iii) only

(B) (ii) and (iv) only

(C) (i), (ii) and (iii) only

(D) All of the above

[Answer: C]

CHAPTER 4

FEATURES OF THE PRIVATE RETIREMENT SCHEMES

Learning objectives

This chapter discusses the features and characteristics of PRS in detail as well as other main components of a PRS. This chapter also looks at the disclosure document and the various fees and charges of the PRS.

At the end of this chapter, you should be able to:

- describe the coverage of the PRS;
- list the tax incentives and account structure of the PRS;
- explain the default option and the parameters of the core funds;
- describe the circumstances for withdrawals from the PRS;
- explain the mechanism for switching between funds and the ability to transfer between PRS Providers (portability);
- explain the concept of vesting, vesting schedules and accrued benefits;
- explain forward pricing when selling and redemption occurs, and the impact of splitting and distribution of income on the net asset value (NAV) per unit of the fund;
- describe the various fees and charges and their impact on the funds under the Scheme;
- describe the various sections associated with the disclosure document, including the Product Highlights Sheet, the key data section and the supplementary disclosure documents;
- explain the importance of the portfolio turnover ratio and the possible impact on returns; and
- recognise the legal consequences associated with false and misleading statements in the disclosure documents.

4.1 General

The PRS is defined as a capital market product and is a voluntary long-term investment scheme designed to help individuals accumulate savings for retirement. The SC will approve the PRS Providers, Scheme Trustee and PRS as well as license the PRS Distributors where applicable to ensure a minimum standard of conduct and the delivery of reasonable investment advice to the individual members of the Scheme.

A PRS consists of a range of funds which are called core funds and non-core funds. The PRS will also be invested in different types of asset classes which are briefly elaborated below.

Bonds

A bond is a debt investment where an investor loans money to an entity (corporate, supra-national or governmental) that borrows the funds for a defined period of time at a fixed interest rate. Bonds are used to finance a variety of projects and corporate activities. Bonds are also commonly referred to as fixed income securities as the coupon payment from these bonds are pre-determined and contractual. The level of a bond's interest rate is determined by the credit quality of the issue and the duration of the bond. The lower the credit quality of the issuer, the higher the expected interest rate. As for the duration of the bond, the longer the maturity of a bond, the higher the expected interest rate of the bond.

Equities

The word signifies an ownership position or equity in a corporation. The equity holder only enjoys residual claim on the corporation after all prior claims have been settled (i.e. claims by debt holder etc.). In relation to PRS, equities refer to stocks and shares of companies that the fund under the Scheme invests in. The returns to the fund under the Scheme come in the form of dividends received, and capital appreciation of the stock.

Money market instruments

These are financial assets that have high liquidity and very short maturity (less than a year). Money market instruments consist of certificates of deposits (CDs), bankers' acceptance, treasury bills, commercial papers and repurchase agreements (repos). The money market is used by participants as a means of borrowing and lending in the short term.

Collective investment schemes

A collective investment scheme is a way of investing together with other investors in order to benefit from the advantages of working as part of a group.

These advantages include the ability to hire professional investment managers, costs sharing and diversification. Collective investment schemes are defined under the PRS Guidelines and include, among others unit trust funds, real estate investment trusts, exchange-traded funds, wholesale funds and closed-end funds.

Derivatives

A derivative is a security whose price is dependent upon or derived from one or more underlying assets. The derivatives contract is between two or more parties whose value is determined by the fluctuations in the underlying asset. The common types of derivatives are futures contracts, forward contracts, options and swaps.

Derivatives can be used to hedge a risk. An example of this would be a Malaysian company hedging US$ receivables through a currency option because there is a belief that the US$ will weaken. Derivatives can also be used for speculation. Buying a Malaysian government bond futures contract to profit from an expected drop in interest rates is an example of speculative behaviour.

Real estate

Real estate is defined as land and anything permanent that is fixed on it, including buildings, fixtures and any items attached to the structure. Real estate can be grouped into three broad categories based on its use, namely residential, commercial and industrial. Examples of real estate would include houses, apartment blocks, undeveloped land, office buildings, retail complexes, condominium and factories.

Unlike other assets, real estate is most affected by local conditions of the immediate area where the property is located. With the exception of a global or national recession, real estate prices would be most influenced by local factors including the availability of jobs, crime rate, presence of good schools, local property taxes, proximity of shops and access from major roads.

(a) Coverage

(i) Eligibility

The PRS is open to both Malaysian and foreigners alike. The members must be individuals who are 18 years of age and above. Employers may also contribute to the Scheme as a benefit to their employee or to encourage job loyalty by having a vesting schedule which stretches out the vesting period for their contributions.

(ii) Contribution

Since the PRS is a voluntary scheme, there are neither required fixed amounts nor fixed intervals for making contributions (although the individual PRS Providers may set a minimum and maximum contribution for each of the funds they offer). A lifetime private pension account would be opened by the PPA upon the member completing the relevant account opening form and/or fulfilling other requirements. At the time of opening of the private pension account, potential members are not required to make contributions to the Scheme. The PPA does not accept monies/contributions from members. To make contributions, members will have to indicate their investment direction to the PRS Provider. This can be done simultaneously when opening the private pension account or at a later stage.

Where a member registers to open a private pension account and makes a contribution at the same time, PRS Providers are not required to wait until the private pension account is opened before subscribing units for funds under the Scheme as selected by the member.

Contributions can stop and also start up again after any lapse of time. The member may also contribute to more than one Scheme although once again the PRS Provider may limit the numbers of funds that the member can join within a Scheme. PRS Providers set the minimum and maximum contribution amount that can be made by members.

(b) Default option

The default option is available to members who choose their PRS Provider but do not make a fund option. An example of this is when an employer makes a contribution to a member's account but the employee does not specify the fund to be invested in, the amount would automatically be allocated using the default option which is based on the age of the member.

PRS Providers are to obtain satisfactory evidence of the member's identity and age for all forms and documents received on behalf of the PPA, and have effective procedures for verifying the member and these must include–

- establishing the member's full and true identity;
- verifying the identification given, where required; and
- establishing where appropriate, the clients' financial position, investment experience, and investment objectives.

There are three core funds in the default options which must be offered under any PRS. The table below provides further details including the asset allocation of the core funds under the default option:

	Growth Fund	Moderate Fund	Conservative Fund
Age group	Below 40 years of age	40 years and above but have not yet reached 50 years	50 years of age and above
Parameters	Maximum 70% equities *Investment outside Malaysia is permitted	Maximum 60% equities *Investment outside Malaysia is permitted	80% in debentures/ fixed income instruments with a minimum of 20% money market instruments and a maximum of 20% equities- *Investment outside Malaysia is not permitted

The age brackets are selected based on the life cycle approach to investing. Those below the age of 40 still have a long time to accumulate savings for retirement and can afford to be heavily invested in equities. Even if there are years of negative returns, the investor can sit out these negative returns and wait for a market recovery with time. The investors in the 40 to 50 age bracket will have to start considering that retirement is within one or two market cycles. The equities portion is reduced to a maximum of 60% and the portfolio becomes more balanced with more income producing assets. When the investor reaches 50, retirement is imminent and the investor cannot afford to sit out market cycles anymore given he is moving from accumulation to decumulation phase. The portfolio needs to consist of more income producing assets and very few risky assets (equities).

It is important to note that a member can actively select to contribute to the above three core funds which are the default options if they so choose.

The PRS Provider will have to notify the member one month in advance in writing that the member's investment in the core funds will be switched according to the rules of the default option unless the member instructs otherwise. At this juncture, a member should also receive general investment advice and market outlook. This would facilitate decision making by the member as to whether he or she wishes to remain under the default option which would automatically change according to their age or choose a particular fund. Where an individual becomes a member and has made his first contribution to the Scheme a month before he attains the age of 40 or 50 years old as the case may be, the PRS Provider must allocate such contribution to the moderate fund or conservative fund as the case may be.

(c) Voluntary contributions

(i) <u>Tax incentives</u>

There is a tax relief of RM3,000 per annum for individuals if they choose to contribute into a PRS. This relief is available for the next 10 years from 2012 and can be used for contributions to more than one PRS.

Employers contributing for employees may enjoy an additional tax deduction above the mandatory EPF contribution and up to 19% of the employee's remuneration. All PRS are also tax exempt from interest income received. This effectively increases the returns of the Schemes compared to non-exempt funds and is another advantage of the PRS.

(ii) Account structure

All contributions made to the PRS will be allocated and maintained in two sub-accounts:

- 70% of all contributions made to any fund within the Scheme is held in sub-account A and cannot be withdrawn until the member reaches the retirement age.

- 30% of all contributions made to any fund within the Scheme is held in sub-account B and can be withdrawn once a year upon payment of a tax penalty.

Retirement age is defined under the PRS Guidelines as the age of 55 or the compulsory age of retirement from employment as specified under any written law.

(iii) Example of contribution allocations

For illustration of the split into the two accounts, please see example of the contribution allocation in the diagram below.

Contributor 1

Provider XY

RM700 → sub-account A; RM300 → sub-account B

sub-account A				sub-account B			
Date	Fund Name	NAV (RM)	No. of units	Date	Fund Name	NAV (RM)	No. of units
1/5/X3	XY Bond Fund	1	700	1/5/X3	XY Bond Fund	1	300

On 1/1/X4, Contributor 1 makes additional contribution of RM1,000 to XY Bond Fund:

RM700 → sub-account A; RM300 → sub-account B

1/1/X4	XY Bond Fund	2.00	(RM700 /2 + 700 = 1,050	1/1/X4	XY Bond Fund	2.00	(RM300 /2 + 300 = 450

Investment Value as at 1/1/X4: 1,050 units x RM 2 = **RM2,100**

Investment Value as at 1/1/X4: 450 units x RM 2 = **RM900**

Provider YZ

RM700 → sub-account A; RM300 → sub-account B

sub-account A				sub-account B			
Date	Fund Name	NAV (RM)	No. of units	Date	Fund Name	NAV (RM)	No. of units
1/5/X3	YZ Equity Fund	1	700	1/5/X3	YZ Equity Fund	1	300

On 1/1/X4, Contributor 1 makes additional contribution of RM1,000 to YZ Bond Fund:

RM700 → sub-account A; RM300 → sub-account B

1/1/X4	YZ Equity Fund	0.50	(RM700 /0.50 + 700 = 2,100	1/1/X4	YZ Equity Fund	0.50	(RM300 /0.50 + 300 = 900

Investment Value as at 1/1/X4: 2100 units x RM 0.50 = **RM1,050**

Investment Value as at 1/1/X4: 900 units x RM 0.50 = **RM450**

Say Contributor 1 initially contributes RM1,000 into Provider XY on 1 May 20X3. The RM1,000 contribution will be split as usual 70/30 into sub-account A and sub-account B respectively with sub-account A receiving RM700 and sub-account B receiving RM300. These will be used to purchase XY Bond Fund with an NAV of RM1 on that particular day.

On 1 January 20X4, Contributor 1 makes another contribution of RM1,000 into Provider XY and continues to choose the XY Bond Fund. As usual, the RM1,000 contribution is split 70/30 into sub-account A and sub-account B respectively. On 1 January 20X4, the NAV of XY Bond Fund rises to RM2.00. Thus the contribution on 1 January 20X4 will only allow Contributor 1 to buy 350 units of XY Bond Fund (RM700/NAV of RM2) for sub-account A and 150 units of XY Bond Fund for sub-account B. In total, on 1 January 20X4, Contributor 1 will have 1,050 units in sub-account A worth RM2,100 and 450 units in sub-account B worth RM900.

<u>Investments in XY Bond Fund</u>

Date	Total Contribution (RM)	Allocated to sub account A (RM)	Allocated to sub account B (RM)	NAV per unit (RM)	Units purchased (sub-acc. A)	Unit purchased (sub-acc. B)
1 May 20X3	1,000	700	300	1.00	700	300
1 Jan 20X4	1,000	700	300	2.00	350	150

<u>Investment value in XY Bond Fund</u>

Date	Units purchased (sub-acc. A)	Unit purchased (sub-acc. B)	Cumulative holding (sub-acc. A)	Cumulative holding (sub-acc. B)	NAV per unit (RM)	Sub-account A value (RM)	Sub-account B value (RM)
1 May 20X3	700	300	700	300	1.00	700	300
1 Jan 20X4	350	150	1050	450	2.00	2100	900

On 1 May 20X3, Contributor 1 also decides to participate in Provider YZ by buying the YZ Equity Fund. He contributes RM1,000 which once again is split 70/30 into sub-account A and sub-account B respectively. With the NAV of YZ Equity Fund at RM1 on that day, Contributor 1 can buy 700 units for sub-account A and 300 units for sub-account B.

On 1 January 20X4, Contributor 1 makes another contribution of RM1,000 into Provider YZ and continues to choose the YZ Equity Fund. As usual, the RM1,000 contribution is split 70/30 into sub-account A and sub-account B respectively. On 1 January 20X4, the NAV of YZ Equity Fund drops to RM0.50. Thus the contribution on 1 January 20X4 will allow Contributor 1 to buy 1400 units of YZ Equity Fund (RM700/ NAV of RM0.50) for sub-account A and 600 units of YZ Equity Fund for sub-account B. In total, on 1 January 20X4, Contributor 1 will have 2100 units in sub-account A worth RM1,050 and 900 units in sub-account B worth RM450.

Investments in YZ Equity Fund

Date	Total Contribution (RM)	Allocated to sub account A (RM)	Allocated to sub account B (RM)	NAV per unit (RM)	Units purchased (sub-acc. A)	Unit purchased (sub-acc. B)
1 May 20X3	1,000	700	300	1.00	700	300
1 Jan 20X4	1,000	700	300	0.50	1,400	600

Investment value in YZ Equity Fund

Date	Units purchased (sub-acc. A)	Unit purchased (sub-acc. B)	Cumulative holding (sub-acc. A)	Cumulative holding (sub-acc. B)	NAV per unit (RM)	Sub-account A value (RM)	Sub-account B value (RM)
1 May 20X3	700	300	700	300	1.00	700	300
1 Jan 20X4	1,400	600	2,100	900	0.50	1,050	450

Note the following:

All new contributions to whichever PRS Provider and funds within the schemes must always be split 70/30 into sub-account A and sub-account B respectively.

All withdrawals from sub-account B except those occurring at retirement are classified as pre-retirement withdrawals and are subjected to a tax penalty collected by the PRS Provider on the withdrawal amount.

(d) Vesting

(i) Accrued benefits

"Accrued benefits" is defined as the amount of a member's beneficial interest in a PRS. In the context of PRS, accrued benefits are the amounts accumulated in both sub-account A and B. Contributions that are subject to a vesting schedule may result in the issuance of vested and conditionally vested units. Members who hold vested and conditionally vested units will enjoy equivalent rights as members of a fund. However, a member holding conditionally vested units is not permitted to request for a transfer of such units to another PRS Provider or to withdraw any such units. PRS providers are only required to maintain sub-accounts A and B for vested units.

The accrued benefits of a member are protected from judgement debt and cannot be the subject of a charge, lien, pledge or assignment under section 139ZA of the CMSA. Section 139Y(2) of the CMSA also adds that income or profits derived from the investment of accrued benefits of a member of an approved PRS, after taking into account any loss arising from any such investment, shall also vest in the member as accrued benefits as soon as they are received by either the PRS Provider or the Scheme Trustee, whichever is earlier.

(ii) <u>Vesting schedules</u>

Employers may make the contributions to the PRS subject to a vesting schedule to promote employee loyalty. The PRS Providers are to ensure that such benefits are not transferred to another PRS Provider or to be withdrawn by the employee until they are vested unconditionally.

The vesting schedule is an optional feature of the PRS and is subject to the schedule that determines the entitlement of an employee's accrued benefits based on terms of service.

For the purposes of employers who make contributions into PRS on behalf of their employees, the manner in which the accrued benefits will be accounted for and vested in a member may be in accordance with the vesting schedule issued by the respective employer.

Example:

Employer XYZ has a graded vesting schedule where they vest the employer's contributions on the following anniversaries of the employee's employment:

After 1 year of service	0% vested
After 2 years of service	25% vested
After 3 years of service	50% vested
After 4 years of service	75% vested
After 5 or more years of service	100% vested

So if an employee leaves after three years of service, only 50% of the amount set aside by the employer will be vested in the PRS. The employee has lost a portion of their savings due to the forfeiture of the contribution by the employer. Hence, the idea of the loyalty scheme is to encourage employees to stay with the current employers at least until the vesting schedule is complete to enjoy 100% of the accrued benefits.

(iii) Duties of a PRS Provider with respect to vesting

It would be the obligation of the PRS Provider to ensure that the key circumstances or conditions for members that have contributions based on a vesting schedule are covered by the respective vesting schedule. The terms and conditions of the vesting schedule must include but is not limited to the following:

- terms and conditions of the employer's contribution and of the vesting of units issued;
- the rights attached to vested and conditionally vested units, including any limitation on the rights attached to conditionally vested units;
- whether conditionally vested units will be unconditionally vested under circumstances including but not limited to the following-
  - cessation of the employee's employment (under various circumstances)
  - where the employer is in the course of being wound up or otherwise dissolved;
  - where a receiver, a receiver and manager or an equivalent person has been appointed in respect of any property of the employer;
  - where the employer has, whether within or outside Malaysia entered into a compromise or scheme of arrangement with its creditors, being a compromise or a scheme of arrangement that is still in operation;
  - merger of the employer with, or acquisition of the employer by, another entity;
  - termination of the vesting schedule;
  - death of the employee; and
  - any other circumstances as may be specified by the SC.

Upon being notified of any of the circumstances stipulated in a vesting schedule as stated in the previous paragraph, PRS Provider is required to-

- repurchase the conditionally vested units and pay the proceeds to the respective employer not later than 10 days after being notified; or
- vest the conditionally vested units in that member or in that member's estate as soon as practicable.

(e) Members withdrawal from PRS

(i) Pre-retirement withdrawal

Members are allowed to withdraw from sub-account B (30% of their contributions) for their pre-retirement needs for any reason but any pre-retirement withdrawals are subject to a tax penalty. Members may withdraw lump sum or any amount from one or multiple funds of each PRS Provider once a year. The first withdrawal can only be made one year after the initial contribution (whether via member contribution or employer contribution). Members will have to approach the PRS Provider and need to fill in a form made available by their respective PRS Providers. When the application is submitted to the PRS Provider, the PRS Provider will do the necessary verification and ensure that the member is withdrawing according to permitted rules, such as for the first time that year.

PRS Providers would not be required to obtain prior authorisation of the PPA before processing the withdrawal. The PRS Provider has to verify the pre-retirement withdrawal form and instruct the scheme trustee to facilitate the pre-retirement withdrawal by cancelling the units. However , for withdrawals following the death of a member, a PRS Provider must obtain prior authorisation from the PPA before issuing instructions to the Scheme Trustee to cancel units. The PRS Provider is tasked to collect the tax penalty on behalf of the Inland Revenue Board and must deduct the penalty sum before crediting the member's account. The tax penalty for pre-retirement withdrawal is a flat 8%. The amount is to be deducted by the PRS Provider from the amount withdrawn from sub-account B as pre-retirement withdrawal by the member. However, this 8% tax penalty will not apply to pre-retirement withdrawals that are due to death or permanent departure of a member from Malaysia.

Example:

Jon started contributing to PRS Alpha on 1 January 20X3 and on 31 December 20X4 (after 2 years), he has accumulated RM7,000 in his sub-account A and RM3,000 in his sub-account B. He has not made any withdrawal since he started his contribution.

On 1 January 20X5, Jon can apply for pre-retirement withdrawal to withdraw either the full amount (RM3,000) or any partial amount from his sub-account B. The tax will be a flat 8% on whatever the withdrawal amount.

If instead, on 1 January 20X5, Jon decides to immigrate to Australia and leaves Malaysia permanently, he can apply to withdraw from the PRS. In that case, he must withdraw the total full amount of RM10,000 from sub-account A and sub-account B together as partial withdrawal is NOT allowed. Jon will NOT be subjected to the 8% tax penalty for this withdrawal.

The member can only obtain information on consolidated holdings or total amount in sub-account B from the PPA whereas specific information on pre-retirement withdrawal amounts of a particular PRS Provider can be obtained from the relevant PRS Provider.

(ii) Post-retirement withdrawal

Upon reaching retirement age, a member can withdraw from the PRS account (both sub-account A and B) without incurring any tax penalty. The withdrawal can be in the form of a lump sum or on a periodic basis at the request of the member. Alternately, the member can choose to retain their savings in the PRS for continuous investment under their current schemes.

Request for withdrawal upon retirement may be made directly to the PRS Providers by completing relevant forms. Prior authorization from PPA is not required. However, PRS Providers are required to notify PPA that a withdrawal has been made.

(iii) Permanent departure from Malaysia

Members can also withdraw from the PRS if they leave Malaysia permanently through emigration. For foreigners, it would be upon cancellation of the relevant documentation such as work permit or permanent residency. Further details on the required documentation can be found on PPA's website.

(f) Switching between funds within the Scheme

Switching between funds within the Scheme is allowed. The funds in a PRS are at the sole disposal of the member who may make switches to accommodate asset allocation decisions or due to changes in market outlook. For example, a member may switch from a bond fund to a money market fund when he feels that interest rates have a good chance of moving higher or to move out of an emerging market equity fund if there is political turmoil in that country. The PRS Providers are encouraged to charge low or no switching fee for fund switching within the same PRS. The PRS Provider has the right to prescribe the circumstances and to limit the number of times in a year that the member can switch their choice of funds within a PRS.

It is important to note that the member can switch between core funds as well as well as non-core funds. The funds in the PRS are at the member's disposal and if he feels that a fund is suitable at the present time, he is given the flexibility to switch to that fund. If an employer makes a contribution on behalf of an employee whether subject to a vesting schedule or otherwise, the choice of funds under the Scheme (including the right to switch to another fund under the Scheme) is to be made by the employee.

(g) Transfer between PRS Providers (portability)

One of the distinct advantages of the PRS is the ability of members to transfer between different PRS Providers prior to a member reaching the retirement age. This portability feature allows the member to choose the PRS Provider which is ideal to the member's unique circumstances and demands.

Transfers of accrued benefits can be done by completing PPA's transfer form (TF), a copy of which can be obtained from PRS Providers. Members will need to approach the Transferee PRS Provider to fill up the form. On the TF, the member will need to indicate the total number of units to be transferred from the relevant fund(s) of the Transferor PRS Provider and indicate the name of the fund(s) to be transferred into and the number of units to be transferred. A member may make a full or partial transfer from one or multiple funds managed by the Transferor PRS Provider.

Members would not be required to indicate the breakdown on the number of units to be transferred from sub-account A and sub-account B respectively. The Transferor PRS Providers will fill-up the required details by completing the relevant parts of the TF. The allocation of units between sub-account A and sub-account B would be based on a 70-30 ratio whereby 70% of the units would be redeemed and transferred from sub-account A of the transferor fund(s) to sub-account A of the transferee fund(s) and 30% of the units would be redeemed from sub-account B of the transferor fund(s) and transferred to sub-account B of the transferee fund(s). However, over the years due to pre-retirement withdrawals from sub-account B, there may be insufficient balance in sub-account B to effect the transfer according to the 70-30 ratio, in which case the Transferor PRS Provider would be permitted to redeem the remaining units from sub-account A of the transferor fund(s) to purchase units in sub-account A of the transferee fund(s) in order to fulfill the transfer request.

In the event the TF is properly completed and has not been rejected, the Transferor PRS Provider has 5 business days to perform the necessary verification, redeem the relevant units and pay the Transferee PRS Provider.

Once payment has been made, the Transferor PRS Provider would also alert the PPA and upload the TF on PPA's portal with the additional details included, such as the deduction of transfer and redemption fees (if any) and include the price of the units redeemed for sub-account A and B of each fund. In the event of a rejection, the Transferor PRS Provider would state the reasons for the rejection on PPA's portal and the TF would be returned to the Transferee PRS Provider and member for their further action.

The conditions for transfer between PRS Providers are as below:

(i) The proceeds from cancellation of units in sub-account A (whether from one or multiple funds) must be used to create units in sub-account A of one or multiple funds managed by the Transferee Provider. Similarly the proceeds from cancellation of sub-account B whether from one or multiple funds must be used to create units in sub-account B of one or multiple funds by the Transferee Provider;

(ii) First transfer is being made after one full year from first contribution to any fund under any Scheme managed by the Transferor PRS Provider;

(iii) There had been no prior transfer with the Transferor PRS Provider in that calendar year;

(iv) There are sufficient units in the fund(s) selected by the member for transfer;

(v) Each transfer request is only between two PRS Providers which must involve a transfer of one or more funds from the Transferor PRS Provider to one or more funds of the Transferee PRS Provider; and

(vi) The amount from a particular fund selected for transfer must be transferred to one (1) other fund.

Example 1:

On 1 Jan 20X3, Ishak invests RM1,000 in PRS Alpha and buys 1,000 units of Alpha Bond Fund with an NAV of RM1.00. On that same date, he also invests RM1,000 into PRS Beta and buys 1,000 units of Beta Equity Fund with an NAV of RM1.00.

On 1 March 20X4, Ishak decides to transfer his holdings from PRS Beta to PRS Alpha. The NAV of the respective funds are RM2.00 for the Alpha Bond Fund and RM0.80 for the Beta Equity Fund. PRS Beta will sell Ishak's 1,000 unit holdings in Beta Equity Fund for RM800 (1,000 x RM0.80) and PRS Alpha will buy units of Alpha Bond Fund. For illustration purposes, we assume below the transfer fee to another PRS Provider is RM25 to be charged to PRS Beta. Ishak's holdings from the initial investments until completion of the transfer process are as follows:

Ishak's holdings

Date	Fund Name	Units	Price (RM)	Gross amount (RM) Sub-account A	Gross amount (RM) Sub-account B	Transfer fees (RM)	Net Amount (RM) Sub-account A	Net Amount (RM) Sub-account B	TOTAL (RM)
Initial investment									
1 Jan 20X3	Alpha Bond	1,000	1.00	700	300	*Not applicable*			1,000
	Beta Equity	1,000	1.00	700	300	*Not applicable*			1,000
Before transfer									
1 March 20X4	Alpha Bond	1,000	2.00	1,400	600	*Not applicable*			2,000
	Beta Equity	1,000	0.80	560	240	*Not applicable*			800
Transfer-out process									
1 March 20X4	Beta Equity	1,000	0.80	560	240	25	535	240	775
After transfer									
6 March 20X4	Alpha Bond	1,387.5	2.00	1,942.5	832.5	*Not applicable*			2,775
	Beta Equity	0	0.80	0	0	*Not applicable*			0

Note the following:

- PRS Providers may only charge actual and reasonable expenses incurred in connection with transfers to another PRS Provider or switching between funds within the Scheme as disclosed in the disclosure document.

- Provider's Fees i.e. Redemption Charge and Transfer Fee, where relevant, will be deducted from sub- account A.

- If transfer request is from more than one fund from the same Provider, Transfer Fee will be apportioned depending on number of funds. For example if Transfer Fee is RM25 and involves two funds from the same provider, Transfer Fee for each fund will be RM12.50.

- As with any creation and redemption of units, both PRS Providers must secure the price per unit as at the next valuation point after the request has been received.

- Members must be made aware that as there is a time-lag during the transfer process as the process involves redemption of units and creation of units by different Providers, the fund prices may change due to market movement or fluctuations.

Example 2:

Ahmad has two funds with PRS Alpha and wants to transfer out to Provider Beta (Growth and Average funds). The transfer should be as follows:

TRANSFER-OUT TRANSACTION			TRANSFER-IN
Fund Name	**Units**	**Number of units**	
Alpha Conservative	Full / Partial	Note: For full transfers, member does not have to fill up this column	Beta Growth
Alpha Shariah	Full / Partial	100	Beta Average

Example 3:

Ahmad started working for ABC Company on 1 January 20X4 and ABC Company started contributing RM100 per month to PRS Bravo on behalf of Ahmad, from that same day. On 1 July 20X4, Ahmad also started contributing on his own to PRS Bravo.

On 1 January 20X5, Ahmad is allowed to transfer the accrued benefit in PRS Bravo to another PRS (say PRS Echo) of his choice because:

a) 1 year has elapsed since the first contribution to PRS Bravo; and

b) Contribution to any fund under any Scheme may be made from employers or individuals themselves.

If we assume that Ahmad also contributes to PRS Delta from 1 October 20X3, he is allowed to transfer that accrued benefits from PRS Delta during the calendar year of 20X5 as well because:

c) PRS Delta is different PRS Provider and it is a first time transfer from PRS Delta is requested in that calendar year."

(h) Unclaimed monies and death of members

The PRS Provider will need to maintain the account of the member even if it becomes dormant (no monies received or movement between funds after a certain period). Where the account is dormant for 12 months subsequent to the member's 80th birthday, the Scheme Trustee may pay any unclaimed accrued benefit held by the Scheme Trustee to the registrar of unclaimed monies, in accordance with the provisions of the *Unclaimed Monies Act 1965*. Prior to paying the unclaimed accrued benefits to the registrar of unclaimed monies, the Scheme Trustee must obtain approval of the PPA.

Upon death of a member, the member's personal representative such as the executor or administrator may make an application for withdrawal from the relevant PRS Provider. Supporting documents such as the probate, letter of administration or Sijil Faraid must be sent to the PRS Provider as soon as practicable, which would then be submitted to PPA for their authorisation. Once the prior authorization of the PPA is received, the relevant PRS Provider must within 10 days pay the personal representative of the deceased PRS Member the proceeds of the repurchase of units.

4.2 The Scheme Trustee

(a) Approval from the SC

The Scheme Trustee must be approved by the SC under section 139ZC of the CMSA. Each Scheme is required to have one Scheme Trustee.

(b) Eligibility to be a Scheme Trustee

To be eligible, a Scheme Trustee must–

- be a trust company under the *Trust Company Act 1949* or incorporated pursuant to the *Public Trust Corporation Act 1995*;
- be registered with the SC;
- have a minimum paid-up capital of RM500,000 and a minimum shareholders' funds of RM1 million (or such amount as may be specified by the SC);
- obtain professional indemnity insurance coverage of at least RM5 million in the first year of its registration by the SC and increase its professional indemnity insurance coverage to at least RM10 million in the second year of its registration by the SC, and maintain such coverage thereafter; and
- be independent from the PRS Provider.

(c) Duties and functions

(i) <u>Holds assets in trust for the members of the PRS</u>

The main function of the Scheme Trustee is to take custody and control of all securities, derivatives, property and assets of a PRS and hold it in trust for the members in accordance with the deed, relevant securities laws and any guidelines issued by the SC. In that regard, the Scheme Trustee must exercise the degree of care and diligence that a reasonable man would exercise if he were in the Scheme Trustee's position (the "reasonable man" test) to safeguard the best interest of the members as a whole.

(ii) Dealing in units

The Scheme Trustee, on receiving instructions from the PRS Provider, creates and cancels units of a fund within the PRS, hence facilitating the dealing in units of a fund. The Scheme Trustee may refuse to create units or to create units in the number instructed by the PRS Provider if such creation would result in a breach of the deed, securities laws (including the PRS Regulations) or the PRS Guidelines. Similarly, the Scheme Trustee may refuse to cancel units or to cancel units in the number instructed by the PRS Provider if such cancellation is not in the best interest of members or if it would result in a breach of the deed, securities laws or the PRS Guidelines.

(iii) Accounts and audit

A Scheme Trustee must ensure that the financial statements of the fund are audited annually by an auditor independent of the PRS Provider and the Scheme Trustee and registered with the Audit Oversight Board. The Scheme Trustee may also remove an auditor and appoint another in its place if it deems it necessary. Members may by way of an ordinary resolution request the trustees to replace an auditor.

(iv) Reports to members

A Scheme Trustee must prepare a report to the members to be included in the fund's report on whether the distribution of returns for the fund is relevant and reflects the fund's investment objective.

This report must also state the Scheme Trustee's opinion on whether the PRS Provider has operated and managed the fund in accordance with–

- the limitations imposed on the investment powers of the PRS Provider under the trust deed, the PRS Guidelines, CMSA and other applicable laws;
- the valuation is carried out in accordance with the trust deed and any regulatory requirements; and
- the creation and cancellation of the units are carried out in accordance with the trust deed and other regulatory requirements.

If the Scheme Trustee is of the opinion that the PRS Provider has not done so, then the Scheme Trustee must disclose these shortcomings which may impact the decision of members or potential members to invest in the fund. The Scheme Trustee needs to disclose the steps taken to address the shortcomings and/or to prevent future occurrences.

(v) Oversight function

The Scheme Trustee's main concern is to ensure that the Scheme and the funds under the Scheme are operated and managed in accordance with–

- the deed;
- the disclosure document;
- the PRS Guidelines;
- securities laws, including the PRS Regulations; and
- acceptable and efficacious business practices within the PRS industry.

As such, it is essential that the Scheme Trustee maintains policies and procedures that actively monitor the operations and management of the PRS Provider. This is done through regular compliance review of the investment limits and processes adopted by the PRS Provider. The Scheme Trustee is required to report on any breaches of procedures. An independent auditor must be appointed by the Scheme Trustee to carry out the annual audits of the financial statements to lend credibility to the whole oversight function.

4.3 Fees, charges and expenses

(a) General

This section deals with the fees and charges that affect the PRS member. It is important for the member to understand that higher fees and charges will inevitably detract from long-term fund performance as less of the invested monies actually become available for investment and high expenses reduce the annual performance of the fund as a direct consequence.

The example below illustrates the point. Assume that all the four funds return 10% gross (before fees and expenses) each year for the next 10 years.

	Fund A	Fund B	Fund C	Fund D
Initial sales charge	0%	0%	0%	7%
Annual management fee and expenses	0%	1%	2%	0%
Available for investment at year 0	100%	100%	100%	93%
Gross return each year	10%	10%	10%	10%
Net returns each year	10%	9%	8%	10%
Total returns after 10 years	259.4%	236.7%	215.9%	241.2%

Fund A outperforms Fund B and Fund C merely because the higher fees of Fund B and Fund C results in lesser assets accumulated each year for the member and a smaller compounding factor.

Fund A outperforms Fund D because the initial sales charge of 7% in Fund D means that only 93% of that fund's initial investment is invested for the member. This results in 7% reduction in total return over time.

It is imperative that the member understands the various fees, charges and expenses involved in order to make an informed decision on whether to participate in a PRS. It is also important for the member to note that fees charged to the fund can also be in the form of trustee's fees, fees paid to the PPA and other fees which will impact the fund returns.

(b) Dealing charge/fee for dealing in units

This is the charge imposed on members for participating in the PRS. There may be both an entry fee and an exit fee or just an entry fee. The amount of the charge as well as when it is incurred will be clearly spelt out in the disclosure document. These charges are mainly collected by the PRS Provider to remunerate the PRS Consultant and to cover marketing costs.

In addition, the dealing charge must be clearly permitted by the deed and expressed as a fixed amount or a fixed percentage of the price of a unit or amount invested.

The PRS Provider can change the dealing charge but only after notifying the trustee and the SC of the change and issuing a supplementary disclosure document provided the change is within the range stipulated in the deed. Thirty days must elapse after the supplementary disclosure document is issued before the new dealing charge can take effect. Any increase in the maximum amount or maximum rate stated in the deed can only be made pursuant to a special resolution passed at a meeting of members of the Scheme or the fund within the Scheme, as the case may be.

In the interest of fairness, discounts and rebates in any form are prohibited and the PRS Provider, its sales agents and distributors must clearly inform members and contributors of the actual rate of charges payable.

(c) Remuneration of the PRS Provider and Scheme Trustee

Both the PRS Provider and Scheme Trustee can only be remunerated by way of an annual management and annual trustee fee charged to the fund. The fees must be accrued daily and calculated based on the NAV of the fund (as most PRS Provider and Scheme Trustee's fees are based on a percentage of fund size). These fees must be permitted by the deed and clearly disclosed in the disclosure document and are expected to be reasonable with regard to the roles, duties and responsibility of the respective parties.

The management fee percentage may only be raised by way of a supplementary deed with the members of the fund passing a special resolution to approve the increase.

The PRS Provider is allowed to collect fees on behalf of the PPA as agents. These fees are not remuneration for the PRS Provider and should not be confused with the annual management fee.

(d) Expenses of the fund

Except for fees payable to the PPA, only expenses (or part thereof) directly related and necessary in operating the Scheme and managing a fund may be paid out of the fund. These would include the following:

- Commission or fees paid to brokers or dealers;
- Custodial charges or fees paid to sub-custodians (where applicable);
- Tax and other governmental and local authority charges;
- Audit fee and related expenses by the auditor appointed by the PRS;
- Valuation fees and related expenses by independent valuers for the benefit of the fund;
- Costs incurred in the modification of the deed (other than those that benefit the PRS Provider or Scheme Trustee); and
- Costs incurred in any meeting of members (other than those that benefit the PRS Provider and Scheme Trustees).

The onus is on the Scheme Trustee to ensure that all expenses charged to the fund are legitimate and that the quantum of expenses charged is reasonable with reference to standard commercial rates. The Scheme Trustee itself may be reimbursed for expenses incurred in the course of exercising its duties as a trustee.

(e) Review of fees and charges

The SC has the power to review the fees and charges. Where it finds that the expenses and fees are inconsistent with the objectives of the Scheme or prejudicial to the interests of the members, it may require such expenses and fees to correspond with the services provided.

4.4 Dealing, valuation and pricing

(a) Fund units

Fund units are created and cancelled by the Scheme Trustee upon the advice of the PRS Provider because of new requests by members or potential members of a PRS to buy or to redeem units. Apart from the initial offer of the fund where the initial price is fixed during the offer period (a period not exceeding 21 days), all dealings in the fund must be at the NAV per unit of the fund at the next valuation point (usually the next business day) after the request for the sale or repurchase of units by the PRS Provider. This is known as forward pricing and it is imperative that the member understands the rationale behind this pricing. In circumstances where the prior authorisation of the PPA is required for the repurchase of units, the transaction will be at the NAV per unit of the fund as at the next valuation point after the PPA's authorization has been received by the PRS Provider.

(b) Forward pricing

It is best to explain forward pricing with an example.

Say the published NAV per unit of Fund A (an equity fund) on 20 March 20X2 was RM1.00. Assume that overnight, there was equity market turbulence and the major overseas markets plunged. Member XYZ wants to switch to another fund, hence redeems his one unit in Fund A and submits the request on 21 March. Forward pricing means that Member XYZ would only receive his redemption at the price of the NAV per unit on 21 March (the next valuation point) which turned out to be RM0.98. Allowing Member XYZ to redeem at RM1.00 per unit would disadvantage the rest of the members because Member XYZ would gain RM0.02 per unit at the expense of the rest of the members.

Conversely, say the overseas markets experienced a huge rally and Member QRS wants to buy the fund and submitted his request on 21 March to buy one unit. The NAV on 21 March turned out to be RM1.03. Member QRS could only buy the fund at RM1.03 per unit (the forward price). Allowing Member QRS to buy the fund at historical NAV of RM1.00 per unit (on 20 March 20X2) would be allowing Member QRS to profit at the expense of the other members.

In another example:

Provider A's PRS Fund Pricing	
Date	NAV
23 January 20X4	RM1.00
24 January 20X4	RM1.20

Provider A's valuation point is at 4pm every business day. For Member ABC who submits a request to invest in the PRS fund on 23 January 20X4 at 12pm, the valuation points for his investment would be NAV for 23 January 20X4 which would only be published the following day.

For Member XYZ who submits a request to invest in the PRS fund on 23 January 20X4 at 5pm, the NAV per unit for his investment will be RM1.20.

From the above example, it becomes clear that the forward pricing will depend on the timing of the next valuation point.

For investment requests submitted after the valuation point or time, it will be based on the NAV of the next business day. It is important to note that the PRS Providers have differing valuation points.

(c) Valuation

A fair and accurate valuation of all the assets and liabilities of the fund must be conducted at each valuation point to determine the NAV per unit of the fund. The valuation process must be consistently applied and the valuation process must be verifiable and objective. Once valuation is determined, the Scheme Trustee would have to be immediately notified. The NAV of a fund needs to be published daily on the website of the PRS Provider and the PPA.

The valuation point must be at least once every business day although in some circumstances with limited repurchased arrangement or investments in illiquid assets (like real estate), the daily valuation requirement does not apply. In those cases, the valuation points must be clearly disclosed in the disclosure documents and must be at least once a month.

(d) Distribution, splits and NAV

(i) Impact of splitting on NAV

Splitting the units reduces the NAV per unit but it has no overall effect on the total value of the holdings of a member as the reduction in NAV is compensated by a higher number of units.

Example:

As of 2 April 20X2, Member ABC held one unit of Fund XYZ with an NAV of per unit of RM2.10. A 2-for-1 split was declared on that same date. After the split of the units, Member ABC held two units of Fund XYZ but with an NAV per unit of RM1.05.

(ii) <u>Distributions impact on NAV</u>

Distributions (in terms of dividends) will reduce the NAV per unit because part of the NAV is returned to the member in the form of a cash payment. In the case of the PRS where units must be given in lieu of cash payment, the NAV of the fund will still be reduced because there will be more units created from the same pool of funds. Income distribution in the form of units is akin to unit splitting as above.

Example:

As of 1 March 20X2, Member QQQ owned 800 units of Fund MNO with an NAV per unit of RM2.00. A dividend of RM0.40 per unit was declared and paid on the same date in the form of fund units. Immediately after the payment of the dividend, Member QQQ would hold 1000 units of Fund MNO with a lower NAV per unit of RM1.60. Even though the NAV per unit had been reduced with the distribution, Member QQQ was not made worse off as he still had the same amount of wealth as before.

If the PRS Provider chooses not to distribute income or declare a dividend, the unit price of the fund will increase with the growth of the NAV. At all times, the NAV of a fund should reflect all the available income accrued to it.

4.5 Disclosure document

(a) General

The purpose of a disclosure document is to enable members to make an informed investment decision in contributing to a PRS by providing relevant and accurate information that is material to understanding the management and operation of the respective funds within the Scheme.

Potential members will be given a copy (either a hard or soft copy) of the disclosure document when they request for subscription to a Scheme. These members must be advised to read and understand the disclosure document before making the decision to participate in the scheme.

The contents of a disclosure document must include:

(i) The cover page with the name of the Scheme and date;

(ii) The inside cover of the document with the responsibility statements and statements of disclaimer;

(iii) The table of contents which lists all the sections and subsections of the disclosure document;

(iv) The section on definitions and the corporate directory;

(v) The key data/information summary highlighting the salient features of the funds under the PRS;

(vi) Information regarding the risk factors of investing in the fund;

(vii) The PRS details;

(viii) The details of the funds under the Scheme including the investment objectives;

(ix) The fees, charges and expenses which are the costs of investing in the fund;

(x) Transaction information including information on valuation points and procedures on purchasing and redeeming units;

(xi) A section on the PRS Provider with corporate information and information on the investment committee, the audit committee, the Shariah adviser and the panel of advisers where applicable;

(xii) A section on the Scheme Trustee;

(xiii) Salient terms of the deed;

(xiv) Related-party transactions and areas of potential conflict of interest;

(xv) Taxation of the fund;

(xvi) Statement of consent from relevant parties including among others, auditors, valuers, solicitors and other experts;

(xvii) A statement stating that all relevant documents are available for inspection at the registered office of the PRS Provider; and

(xviii) Specific requirement for the various different types of funds.

(b) Product Highlights Sheet

A Product Highlights Sheet is to provide a summary of the key information on the fund(s) under the Scheme to potential members. A Product Highlights Sheet must be prepared for each fund under the Scheme except for the core funds of the Scheme which must be covered under one Product Highlights Sheet.

The Product Highlights Sheet must follow the template provided as Appendix I of Schedule G of the PRS Guidelines which may be specified by the SC from time to time and at all times must reflect information in a clear, concise and effective manner. To that end, the Product Highlights Sheet must be prepared in easily-understood language and where necessary use simple charts, tables, diagrams to act as an aid for better presentation of information.

The Product Highlights Sheet, whether in hard or soft copy, must be presented to the potential member at the initial engagement or at the point the individual shows interest in the PRS. The Product Highlights Sheet must include, but not limited to, the following information:

(i) Scheme information

- Name of Scheme;
- General information on the Scheme. This should include a brief description of the benefits of contributing to the Scheme;
- Brief description of the operations of the Scheme;
- Statement that there are other funds that have been launched within the Scheme which are not the subject-matter of the Product Highlights Sheet in question;
- The number of funds within the Scheme, the name of each fund and the type of each fund.

(ii) Fund information

- Name of fund;
- Category of fund;
- Investment objectives of the fund;
- Brief but relevant description of the principal investment strategy, including the asset allocation strategy to be employed by the fund manager to meet the objectives;

- Performance benchmark;
- Member profile; and
- Where multiple classes of units are issued, a comparison table highlighting the different features of each class.
- For a Shariah-compliant fund, the following statement must be disclosed : "<<name of fund>> has been certified as being Shariah-compliant by <<name of Shariah Adviser appointed for the Fund>>

(iii) <u>Fees and charges</u>

Explanation of :

- all fees and charges for each fund(s) that is the subject-matter of the Product Highlights Sheet and should be clearly identified in tabular form; and
- how members will be notified of any increase in fees and charges, including whether there is any notice period required prior to the effective date of such higher fees and/or charges.

(iv) <u>Taxation of the fund</u>

A Product Highlights Sheet must contain briefly:

- the taxation of the fund under a Scheme, taking into account any distinctive characteristic of the fund;
- with regard to members, the tax deduction available and tax liabilities (including the tax penalty for withdrawals prior to retirement), if any; and
- maximum tax deduction available for employers who contribute on behalf of employees.

(v) <u>Risk factors</u>

A Product Highlights Sheet must highlight general investment risks and risks specific to the fund(s) the subject-matter of the Product Highlights Sheet.

(vi) Other information

- Avenues of advice for prospective members ;
- Information on how the member can keep abreast of developments in the fund, track the NAV per unit of the fund and their contributions to the scheme;
- Where and how members can lodge a complaint;
- The following statement must be disclosed (in bold)

  "This is a Private Retirement Scheme"

  "There are fees and charges involved and investors are advised to consider them before investing in the fund"

  "Unit prices and distribution payable, if any, may go down as well as up"

- Where a fund proposes to invest substantially in derivatives (that is more than 30%), a warning statement (to appear in bold) must appear to warn of the likelihood of high volatility in the NAV of the fund due to these derivatives; and
- Any other information that the PRS Provider may consider necessary, material and important to be included in a Product Highlights Sheet.

(c) Key data section/information summary

A key data/information summary section in the disclosure document highlights salient features of the fund and where necessary, includes cross-references to pages in the disclosure document which gives full details on the respective matters. It is important for PRS Consultants to draw the members' attention to this section as it discloses the charges and fees incurred in the investing of the units of the fund.

The summary section should include the following information:

(i) Scheme information

- Name and general information of the Scheme;
- Brief description of the operations of the Scheme; and
- The number of funds within the Scheme and the name of each fund and type of fund.

(ii) Fund information

- Name, category and type of fund;
- Initial offer period and its initial price;
- Investment objectives of the fund;
- A description of the policies and investment strategies including asset allocation strategies to be used to meet the investment objectives;
- A description of principal risk of investing in the fund; and
- Where multiple classes of units are issued, a comparison table highlighting the different features of each class.

(iii) Fees and charges

- Disclosure of the charges directly incurred by members when purchasing or redeeming units of a fund;
- Clear indication clearly in the disclosure document on whether the charges are negotiable; and
- To disclose fees indirectly incurred by members when investing in the fund.

(iv) Other information

- A list of current deed and any supplementary deeds and their corresponding dates;
- Any key data that the PRS Provider considers necessary, material and important to be included in this section; and
- For a scheme that is already in operation, this warning statement must be included:

  "Past performance of the fund is not an indication of its future performance."

(d) Portfolio turnover ratio

Portfolio turnover ratio (PTR) is an indication of how frequently the assets within a fund are bought and sold by the managers over a measurement period (usually a 12-month period).

The PTR can be calculated as follows:

$$\frac{1/2 \times (\text{total investment purchases} + \text{total investment sales})}{\text{Average fund size for the year calculated on a daily basis}}$$

The PTR measurement should be considered by an investor before deciding to invest in the fund because a fund with a higher PTR will incur higher transaction costs than a fund with a lower PTR. Unless the fund with the higher PTR can justify superior stock selection and switching, a less active trading posture may generate higher fund returns.

(e) PRS member's rights and liabilities

The potential member, when contemplating whether to invest in a Scheme, will have the right to expect that relevant information be given to him to enable him to make a sound decision.

On initial contact with the PRS Consultant, the potential member should be given the Product Highlights Sheet which is a summary of the salient points about the PRS as well as the funds that are being offered. The potential member must be told not to make the investment decision solely on the information obtained from the Product Highlights Sheet but to read the disclosure document in full. The exception to this is when the member chooses to exercise his right not to select any specific funds and to rely on the default option of the PRS. This is usually more prevalent in cases involving employer contribution on behalf of their employees.

The disclosure document which usually contains the account application form is to be given to the member when he wants further information and is ready to commit to investing in the PRS and the funds within. The potential member should be advised to read the disclosure document in its entirety and to seek legal and investment advice if there are any doubts in their minds.

Finally, the potential member has a right to expect the PRS Consultant to be well qualified to provide investment advice and information about the funds and PRS in general. The PRS Distributor and Consultant will be registered with the FIMM as well as licensed by the SC where applicable. In this manner, potential member will be reassured that there is minimum standard of care and professionalism that can be expected from such licensed representatives.

(f) False and misleading statement

Section 92A of the CMSA stipulates that a PRS Provider which breaches any rules in relation to false or misleading statements will have committed an offence.

PRACTICE QUESTIONS

Question 1

Which of these statements are CORRECT with regard to contributions to the Private Retirement Schemes (PRS)?

(i) Employers can contribute on behalf of employees

(ii) The PRS Providers set the minimum contribution amount

(iii) Members can contribute to only one PRS

(iv) Members can stop contributions any time

(A) (i) and (iv) only

(B) (i), (ii) and (iv) only

(C) (i), (ii) and (iii) only

(D) (ii), (iii) and (iv) only

[Answer: B]

<u>The next two questions are based on the scenario below:</u>

Employer ABC contributes to a Private Retirement Scheme on behalf of an employee, Yasmin, subject to a vesting schedule. Yasmin, who is 30 years old, does not contribute to the PRS on her own.

As of 1 March 20X2, the vested amount is RM10,000. The penalty imposed on members for early withdrawal from sub-account B is 8%.

Question 2

As at 1 March 20X2, what is the available amount in Yasmin's sub-account A?

(A) RM3,000

(B) RM7,000

(C) RM9,700

(D) RM10,000

[Answer: B]

Question 3

If on 1 March 20X2, Yasmin decides to do a pre-retirement withdrawal from sub-account B and withdraw all the available balance. What is the net amount due to Yasmin?

(A) RM2,760

(B) RM3,000

(C) RM9,200

(D) RM10,000

[Answer: A]

Question 4

Which of these are examples of expenses that are ALLOWED and paid out from the Private Retirement Scheme?

(i) Custodian fees

(ii) Valuation fees

(iii) Commission paid to brokers

(iv) Expenses to call a members' meeting to increase annual management fees

(A) (i) and (ii) only

(B) (iii) and (iv) only

(C) (i), (ii) and (iii) only

(D) (ii), (iii) and (iv) only

[Answer: C]

CHAPTER 5

CONSTITUTION OF THE PRIVATE RETIREMENT SCHEMES

Learning objectives

This chapter explores the constitution of the PRS.

At the end of this chapter, you should be able to:

- list the different types of funds within the Scheme;
- explain the concept of trust and what an advantage it is to have a Scheme Trustee to care for the interest of the members;
- explain what the trust deed and supplementary deeds are;
- explain how the investment objectives of the fund govern the type of funds offered to members;
- identify the risk level of the core funds and other common types of funds;
- explain the similarities and differences between the PRS and unit trusts; and
- recognise the differences between the PRS and unit trusts as well as other retirement products such as annuities to contrast with voluntary additional contribution to the EPF.

5.1 Type of funds within the Scheme

The purpose of the PRS is to facilitate asset accumulation by members for use in retirement. Thus, a range of funds must be available within the Scheme to cater to the particular demands of the PRS member. The PRS Guidelines allow the PRS Provider to offer a range of seven conventional funds. This limit may increase up to a range of 10 funds if the PRS Provider plans to offer Shariah-compliant funds under the Scheme. Alternatively, a specific Scheme may be established for Shariah-compliant funds only.

Default options are for members who select their PRS Providers but do not specify a fund option. Another case may be where the employer channels contributions to a particular PRS Provider but where employees do not make a fund selection, these contributions will be allocated to the default option of that PRS Provider. The objectives of having the default option of core funds in every PRS are to ensure that for members who do not choose specific funds, their contributions are channelled into a fund that is appropriate given their age.

At all times, the PRS Provider must ensure that the Scheme which it offers to the public has the default options consisting of core funds. The three core funds are–

(i) the conservative fund;

(ii) the moderate fund; and

(iii) the growth fund.

5.2 Instruments constituting the Scheme

(a) Concept of trust

A PRS under the CMSA framework is a retirement scheme governed by a trust.

In common law legal systems, a trust is a relationship whereby property is held by one party for the benefit of another. With regard to the PRS, the Scheme Trustee holds the assets (fund assets like cash, stocks and bonds) on behalf of the member and these assets are held separately from the PRS Provider's assets and segregated by each fund under the PRS and clearly identified as the fund's property.

The composition of these fund assets may change during the course of the year (e.g. from the initial subscription cash to equities and back to cash again for distribution), but the assets always remain under the control of the Scheme Trustee. In the event the PRS Provider encounters financial difficulties and has solvency issues, the members' PRS assets will still be safe as they are segregated from the PRS Provider's assets.

(b) Advantages of the trust arrangement

The Scheme Trustee has a fiduciary duty and a legal responsibility to act impartially in the best interest of the members. Even though the PRS Provider, through the fund manager, has day-to-day operational authority (e.g. they can act on behalf of the fund by buying and selling shares, bonds and other property), the assets and monies reside with the Scheme Trustee. The Scheme Trustee holds assets for the member in trust and segregates them from the assets of the PRS Provider. These assets would be safe even if the PRS Provider experiences illiquidity or undergoes insolvency proceedings as the segregation prevent them from being claimed by any creditors of the PRS Provider.

(c) The deed

Since the PRS is governed by a trust structure, the PRS Regulations impose a requirement for a deed to be registered with the SC to ensure that a trust governing the establishment and operation of the PRS is created and entered into between the PRS Provider and the Scheme Trustee. In this regard, the provisions and covenants of the deed must meet the minimum requirement specified in the PRS Guidelines.

The covenants of the deed will include the duties and responsibilities of the various parties involved (including the PRS Provider and Scheme Trustee), as well as the full particulars of the PRS and funds within the Scheme. The deed must be registered and lodged with the SC. Any modification of the deed can only be done through a supplementary deed which is also required to be registered with the SC.

(i) <u>Covenants of the PRS Provider and the Scheme Trustee</u>

The covenants of the PRS Providers and the Scheme Trustee, the joint covenants of the PRS Providers and Scheme Trustee, as well as other covenants can be found in Schedule C of the PRS Guidelines.

5.3 Authorisation of the funds

The funds under the PRS can consist of core funds and non-core funds which must be authorised by the SC. An application for approval of a Scheme must include the application for authorisation of at least the core funds under the Scheme, whereas for non-core funds, application may be made at any time after the approval of the Scheme containing the core funds.

The authorisation of a fund may be revoked if–

- any information or document furnished in the application is false or misleading or contains a material omission;
- the core funds are not launched within six months of the authorisation;

- the PRS Provider failed to comply with the directions of the SC or the requirements of the PRS Guidelines; or
- it is to protect the interest of the public or the members as a whole.

5.4 Naming of the funds

(a) Core funds (default funds)

The core funds in a PRS are default funds which must be named:

(i) (Insert Name of the PRS Provider) – Growth Fund;

(ii) (Insert Name of the PRS Provider) – Moderate Fund; and

(iii) (Insert Name of the PRS Provider) – Conservative Fund

(b) Non-core funds under the PRS

For non-core funds, the PRS Provider and the Scheme Trustee must ensure that the name given to a fund or class of units must be appropriate, not misleading or conflicts with the name of another fund. The SC has the right to ask the PRS Provider to change the name of the fund or class of units if it deems the name inappropriate.

5.5 Investment objective of the Scheme

The investment objective of the Scheme and the funds within the PRS must be clearly, specifically and sufficiently stipulated in the deed.

(a) Different funds for different risk tolerance

Although the ultimate purpose of the PRS is to facilitate asset accumulation by members for use in retirement, members of the PRS will have different investment objectives and risk tolerance that must be considered. The PRS Consultant needs to assess these objectives vis-a-vis the risk tolerance and advise the members accordingly on what the volatility of returns are like for the funds in the PRS and the possible risk of substantial capital loss if invested in certain funds. The members must realise that potentially high returns come with higher risk.

Members must also be made to realise that although there is a default option, which is age-based, this may not be suitable for all members as some members of that age may prefer a more conservative or aggressive portfolio. The default options are made based on the age of the member and this default allocation follows the investment maxim that if the member's investment horizon is longer (i.e. the member is younger), then the member can afford to take more risks and more volatility of returns. This may not be true for everyone as some young investors may be risk-averse and would prefer a heavier concentration of bonds and some older investors made be just the opposite. The PRS Consultant should ascertain that the member is comfortable with the risk profile of the core funds before recommending them.

Where a member does not select a particular fund under the PRS, a fund within the default option (core funds) that corresponds to their age would be selected by default. The details are listed below:

(i) Conservative fund

Asset allocation for members aged 50 years and above 80% in debentures/fixed income instruments of which a minimum of 20% must be in money market instruments and a maximum of 20% in equities. Investment outside of Malaysia is not allowed under this option.

(ii) Moderate fund

Asset allocation for members aged 40 years and above but have not yet reached 50 years
A maximum of 60% in equities.

(iii) Growth fund

Asset allocation for members below 40 years of age
A maximum of 70% in equities.

It is important to note that the asset allocation decision imposed on the member through the restriction in investible instruments as well as the allowable quantum for the default funds will minimise portfolio risk to make it appropriate for the member's age. For example, maximum allowable limit of 20% in equity investment for the conservative fund limits the volatility and return risks of the fund and this is appropriate given the member is already preparing for retirement and should not be exposed to much risks.

(b) General risk and return profiles of certain types of fund

(i) Cash management fund

Invested primarily in money market instruments and deposits, the volatility of returns for this type of fund is relatively low. The returns of this fund should reflect that of a fixed deposit account and is the least risky compared to other types of funds.

(ii) Conservative fund (a core fund)

With a maximum of 20% invested in Malaysian equities and the rest in fixed income instruments (and a minimum in a money market fund), the volatility of returns are quite low although higher than the cash management fund. Returns would also be higher than the cash management fund but generally lower than those with a lot of equities exposure. The high proportion of fixed income instruments mean that this fund is less risky than equity or balanced funds with higher percentage of equity exposure but more risky than the cash management fund.

(iii) Moderate fund (a core fund)

With a maximum of 60% invested in the Malaysian and overseas equity markets, we can expect the volatility of returns to be quite high and varied. Returns are expected to be higher than the conservative fund in the long run because of the higher equities exposure. This is a balanced fund with a mix of equities and fixed income instruments and will provide diversification of asset returns over time. The high percentage of equities component in the fund means that this fund is more risky than the conservative and cash management fund but less risky than a pure equities fund or the growth fund which has a higher equities component.

(iv) Growth fund (a core fund)

With a maximum of 70% invested in the Malaysian and overseas equities markets, we expect the volatility of returns to be the highest among the core funds. Returns are expected to be higher in the long run because of the higher equities component. The growth fund is less risky than a pure equities fund but more risky than the cash management, conservative and moderate funds due to its higher proportion of equities holdings.

(v) Index funds

The aim of this type of funds is to track an index and replicate the return for its unit holders. The volatility of returns and risk associated with the index funds will be dependent on the type of index it tracks. Some of the possible index funds and their risk levels:

- Country index – Equities emerging markets

  Emerging country indices like China's Shanghai Composite or India's Nifty Index are very volatile. This is a very risky fund due to the 100% equities components. Furthermore, this type fund is made up of emerging market equities which is more risky than developed markets equities.

- **Country index – Equities developed markets**

  Developed country indices like the UK and Japan are made up of more established companies and the returns of the index would be more stable compared to emerging markets. This type of fund is less risky than a fund made up of emerging markets equities but inherently more risky than funds that have less equities components.

- **Regional index – Equities**

  Regional indices provide the investors with more diversification (companies from different countries) and some specific investment objectives (e.g. Asia REITs). The returns would be relatively stable. This type of funds is less risky than the country index funds as it offers more diversification but it is still more risky than bond funds because of the 100% equities component.

- **Global index – Bonds**

  A global index will comprise multiple country components and individual issues. This diversification will result in a stable return profile for this type of index. Furthermore, the underlying asset is less risky compared to equities. This type of fund is less risky than the equities index or country funds but more risky compared to the cash management fund.

(c) Volatility

Volatility is a measure of the variation of a price of a financial instrument over time. The funds mentioned above contain equities, bonds and other assets which have daily variation in prices and hence the fund itself would have daily variation in NAV. A volatile fund is one where the daily returns fluctuated within a large band of possible prices whereas a less volatile fund means that the daily return would fluctuate within a narrower band of possible prices.

5.6 Modification of the deed

A deed may be modified by another deed (called the supplementary deed) if the supplementary deed is–

- registered with the SC;

- accompanied by a special resolution passed by members of the PRS (two-third majority except for the purpose of terminating or winding up a Scheme or fund where at least 3/4 of the value of the units held by members voting at the meeting is required) if the modification materially prejudices the interest of the member (e.g. changes to the investment objectives, change in the risk profile, change in fees and charges); and

- accompanied by a statement from the Scheme Trustee and PRS Provider stating that such modification does not materially prejudice the members and prior notice (of at least 21 days written notice) has been given to the members of the PRS.

5.7 Similarities between unit trusts and the PRS

The unit trusts and the PRS do share some common characteristics. Both provide diversification of assets and have a trustee to look after the interest of the members and unit holders. Both the investments in the PRS and unit trusts are pooled and invested according to the mandate and guidelines of the funds that make up the scheme or unit trust. Both are products to encourage the members and investors to make long-term savings and investment decisions.

So while the underlying products (i.e. funds) are the same for both the PRS and the unit trusts, the PRS has a completely different set of rules and regulations to adhere to.

(a) Comparison between the PRS and other retirement products

(i) <u>Annuities</u>

Annuities are usually purchased from insurance companies and are contracts whereby the annuitant (the person who buys the annuity) receives a series of fixed payments at regular intervals (usually monthly) from the insurers until the death of the annuitant. Each annuity payment represents the repayment of a portion of the purchase price plus interest earned. The purchase price may be done at one go (a lump sum payment) or more likely in the context of saving for retirement, paid monthly/annually over the working life of a person. The annuity payment will start once the person retires or has fully paid the purchase price.

Annuities are common drawdown or post-retirement products whereas the PRS is more geared towards savings accumulation for retirement. Once a member reaches the retirement age, he may use the PRS funds to purchase an annuity that would provide him with regular income for a fixed period or until his death depending on the terms of the annuity. There is no uncertainty to the return and payout as the annuities are contractual and pre-determined as it is just a contractual agreement with the insurance company. It is fully funded and the returns are pre-determined.

One of the drawbacks of the annuity is that the annuitant would have to bear the risk of the insurance companies as they are the ones guaranteeing the returns of the annuity. There is no direct link on market performance to the return of the product and the return will depend on the financial health of the insurer. Another drawback is the surrender of the annuity. If the annuitant cannot make the payments and is forced to surrender the policy, then the annuitant stands to lose a substantial portion of the paid contribution. Commission rates may also be hefty for these products.

(ii) <u>Investment-linked insurance products</u>

An investment-linked insurance product combines elements of investing and life insurance into a financial product. The premiums provide not only a life insurance cover but part of the premium will also be invested in specific investment funds of your choice. The insured will be able to choose how to allocate the insurance premiums towards protection and investment.

This is predominantly an insurance product and the cash value of this product can be derived after deducting the unallocated premiums which are commissions to agents (maybe up to 160% of the premium payable over at least six years), insurance charges, policy fee and fund management charges. It is apparent that there is hardly any surrender or cash value in this type of product in the first years of the policy until the unallocated premium and other charges are paid up and enough of the premium gets allocated to the investment fund and the investment returns start to build up.

(iii) <u>Private retirement schemes</u>

Core funds

Every PRS has to offer three types of core funds – the conservative fund, the moderate fund and the growth fund. The unit trust provider and insurance companies on the other hand can offer any type of funds to the investing public. The choice offered is often based on the demand indicated by the public. There are no choices of funds within an annuity.

Default option

Every PRS has core funds that will be default options for members who do not make a fund selection. The core funds attempt to place the member into a category of fund with risks that are commensurate with the age of the member (i.e. the investment horizon of the member).

Every unit trust holder and buyer of insurance products must specify the fund that they wish to buy before a transaction can take place. There is no default option for other retirement products.

Sales of units and withdrawal of monies

The PRS is meant to encourage members to save for the long term and for their retirement. The contribution into a PRS sub-account A thus cannot be withdrawn until the member reaches the retirement age. Only contributions into sub-account B may be withdrawn and even then, withdrawals may only be made once a year and subject to a tax penalty.

There is no such restriction for unit trusts. Investors can generally buy and sell unit trusts freely subject to the specific restrictions of each unit trust. For investment linked insurance products, the cash value in the first years of the policy would be low and it may not be worthwhile for the investor to cancel the policy then.

(b) Advantages of the PRS over other retirement products

(i) PRS investments are portable

The member can easily transfer the accrued benefits from one PRS to another managed by a different PRS Provider through the PPA. For unit trusts and investment linked insurance products, the investors may be subject to high dealing charges again when making the subsequent purchase. Given the nature of the investment-linked insurance product, the policy holder may get back far less than what they had paid for earlier.

(ii) PRS contributions are eligible for income tax relief

Up to RM3,000 per annum of contributions to the PRS are eligible for tax relief. Annuities also enjoy this tax benefit but monies used to buy other retirement products like unit trusts are on an after-tax basis.

PRACTICE QUESTIONS

Question 1

PRS Provider Delta has three core funds in their Private Retirement Scheme. Which of these names can be accepted as names of the core funds?

(i) Delta Growth Fund

(ii) Delta Cash Management Fund

(iii) Delta Moderate Fund

(iv) Delta FBMKLCI Tracker Fund

(A) (i), (ii) and (iii) only

(B) (i) and (iii) only

(C) (ii) and (iii) only

(D) (ii) and (iv) only

[Answer: B]

Question 2

Arrange these funds from the most volatile returns to the least volatile:

(i) Equities Emerging Market Index Tracker fund

(ii) Conservative fund

(iii) Moderate fund

(iv) Cash Management fund

(A) (i), (ii), (iii) and (iv)

(B) (i), (iii), (ii) and (iv)

(C) (i), (iii), (iv) and (ii)

(D) (iv), (iii), (ii) and (i)

[Answer: B]

Question 3

What are the similarities between the Private Retirement Schemes and unit trusts?

(i) Both encourage long-term investments

(ii) Both are governed under a trust structure

(iii) Both have core funds

(iv) Both investments are pooled according to the mandate of the funds

(A) (i) and (ii) only

(B) (ii), (iii) and (iv) only

(C) (i), (iii) and (iv) only

(D) (i), (ii) and (iv) only

[Answer: D]

CHAPTER 6

PRIVATE RETIREMENT SCHEME INVESTMENTS

Learning objectives

This chapter explores the investments that are allowed in the Scheme and their suitability for the member. It provides the PRS Distributor and Consultant, the necessary steps to perform a suitability analysis for the member in recommending funds to him. There are also various discussions on the exposure and concentration limits for the different types of funds in the Scheme.

At the end of the chapter, you should be able to:

- assess the suitability of a PRS and its funds for a member;
- determine whether the funds offered in the PRS are relevant, consistent and appropriate with respect to the investment objective of the Schemes;
- explain the types of investments possible for a PRS;
- recognise the exposure and concentration limits imposed on each type of fund in the PRS;
- recognise the remedial action to be taken on any breach of those limits; and
- assess investment performance and returns.

6.1 Suitability assessment

Each PRS has different fund objectives and hence, different types of funds that may be offered to the members. The PRS Distributor and Consultant should only recommend a fund(s) under the Scheme to a member when the product is suitable. In order to determine whether the fund recommended to a member is suitable or otherwise, the PRS Distributor and Consultant must conduct a suitability assessment.

A suitability assessment refers to an exercise carried out by the PRS Distributor and Consultant that would entail them gathering the necessary information from the member in order to form a reasonable basis for recommendation. The PRS Distributor and Consultant are considered to have a reasonable basis in making a recommendation when they have–

- taken all practicable measures to ascertain that the information possessed and relied upon concerning the member's investment objectives, financial situation and particular needs are accurate and complete; and

- given consideration and conducted a thorough review of the subject matter of the recommendation as may be reasonable in the circumstances.

By having this information, the PRS Distributor and Consultant can recommend a fund to meet the member's risk profile and needs.

A suitability assessment may be conducted face to face or over the telephone or via the Internet or by any other means. What is important is that the documentation of such assessment be accurately preserved. Recommendations obtained from a suitability assessment should be kept in writing.

However, a suitability assessment need not be conducted where:

- an investor does not select a fund within a scheme and therefore a fund is chosen for the investor by way of default;

- an investor is switched to a fund within the default option based on his age category;

- employers channel contributions on behalf of the employees to a private retirement scheme based on employees' choice or request; or

- an investor requests for transfer of accrued benefits between private retirement scheme providers.

Suitability assessment process

The table below sets out the processes that must be complied with when conducting the suitability assessment:

Stage 1	Gather information pertaining to a member
Stage 2	Analyse information gathered
Stage 3	Match a suitable fund to meet the member's risk profile and needs
Stage 4	Make a recommendation

(a) Information gathering for the suitability assessment

Central to the whole suitability assessment process conducted by the PRS Distributor and Consultant is the gathering of information pertaining to a member. Information gathered from the member can be grouped into three categories:

- Know-your-member;
- Member's risk profiles and needs; and
- Member's investment knowledge.

(i) Know-your-member

This part requires the PRS Distributor and Consultant to gather the member's person information to ascertain the type of investor the member is. The information needed is:

- **Member's personal details**
  Includes date of birth, age at the time of recommendation, nationality, residential address, marital status, number of dependents and contact information.

- **Member's employment status**
  Includes current employment status, profession, nature of business if conducting a business, annual income, expected retirement age, category of investor (risk seeking or risk averse – is capital preservation important to the member?).

(ii) Member's risk profile and needs

This part requires the PRS Distributor and Consultant to gather information on the member's investment objectives, financial situation, risk profile and current portfolio. By gathering this information, the PRS

Distributor and Consultant will be able to determine the investor's risk profile and needs. The information needed is-

- **Investment objectives**
  Includes duration the member wishes to invest in the product, rationale for choosing the product, general expectation of outcome of the product and purpose of investment (saving for specific purpose, supplementing income in retirement, lump sum investing for growth/income).

- **Member's financial situation**
  Includes member's assets, liabilities, cash flow, income, proportion of investment out of net assets (excluding residential property) and member's regular financial commitment (e.g. car loan).

- **Member's current portfolio**
  Includes existing portfolio and current performance of that portfolio.

(iii) <u>Member's investment knowledge</u>

This part requires the PRS Distributor and Consultant to gather information on the member's educational qualification, training, work experience and dealing or trading experience. By gathering this information, the PRS Distributor and Consultant will be able to make an assessment whether the member appreciates the risks associated with PRS fund that the member proposes to invest in. The information needed is–

- **Member's relevant knowledge**
  Includes whether the member has dealt in securities and/or derivatives, relevant knowledge or experience to understand the risks associated with the product and investment experience.

- **Member's relevant knowledge to understand the features of the fund**
  Includes whether the member appreciates the special features of the product, nature of the product and product specifications.

(b) Analyse the information gathered

Upon obtaining the know-your-member information, the PRS Distributor and Consultant should analyse the information to determine whether the member has the means and capability to invest and withstand the risks associated with the investment.

(c) Matching and making a recommendation

Having assessed the member's information and financial standing, the PRS Distributor and Consultant must ascertain whether the Scheme they market has a fund that is suitable for the member. If so, they should proceed and make their recommendation to the member.

In making the recommendation of a suitable fund to the member that matches the member's profile and needs, the PRS Distributor and Consultant should also explain to the member the features and risks associated with the fund (both the upside and downside of the fund) before the member makes an informed decision on whether to proceed with the investment. The member should then be given a copy of the disclosure document and a Product Highlights Sheet and advised to read through it before making the investment decision.

If there is no suitable fund available in the PRS that the PRS Distributor and Consultant market, the PRS Distributor and Consultant should inform the member. The PRS Distributor and Consultant should ensure that the recommendation provided to the member is clear and not misleading. They should then document their recommendation in writing for record purposes. The PRS Distributor and Consultant should obtain a written acknowledgement from the member that–

- all information disclosed by the member is true, complete and accurate;
- the member understood the features and risks of the fund having obtained the explanation from the PRS Distributor and Consultant; and
- the member has received a copy of the disclosure document.

As the case may be, the PRS Distributor and Consultant should also obtain from the member a written acknowledgement where the member–

- declines to provide information requested by the PRS Distributor and Consultant; or
- decides to purchase another fund that is not recommended by the PRS Distributor and Consultant.

The PRS Distributor and Consultant are required to furnish the member with a copy of the document containing the recommendation made and the basis of the recommendation. This document should be signed by the PRS Consultant and the member.

6.2 Relevance, consistent and appropriate

The funds offered within the PRS must be relevant, consistent and appropriate given the investment objectives of the Scheme. Over time, the investment performance of the funds can be measured and tracked to determine whether the fund adhered to its objectives and mandate.

One measure to consider is the target investment return and the target volatility of the fund and to compare it with actual investment performance and volatility of returns.

Example 1:

A fund within the PRS holds itself out to be a traditional fixed income fund and has an investment objective to return mid to high single digit percentage returns per annum with medium to low volatility.

The actual returns of the fund for the past three years are:

	Annual return (%)	Annualised volatility (%)
Year 1	7.3	4.2
Year 2	8.5	5.1
Year 3	6.8	4.8

We can infer from the actual returns and volatility patterns over the last three years that the fund is essentially performing according to its objectives and appears to be consistent with its investment mandate.

Example 2:

Fund XYZ in PRS Provider CCC is an equity fund that wants to provide returns which mirrors that of the FBM Kuala Lumpur Composite Index (FBMKLCI). Fund XYZ is essentially a tracker fund.

The actual returns of the KLCI and Fund XYZ for the past three years are:

	FBMKLCI returns (%)	Fund XYZ returns (%)
Year 1	8.9	7.1
Year 2	3.1	-2.2
Year 3	12.3	8.8

It is apparent from the returns that Fund XYZ has done a poor job of tracking the returns of the FBMKLCI. Hence, it has failed in its investment objective to provide returns that mirror the FBMKLCI and Fund XYZ cannot be considered relevant, consistent and appropriate for PRS Provider CCC.

6.3 Types of investments

Please refer to Chapter 8 of the PRS Guidelines (Investments of the Scheme) to determine the types of investments allowed in the PRS.

(a) General

The fund's property must be consistent with the investment objective of the PRS which is to help members accumulate savings for use in their retirement and the prudent man rule suggests that assets be diversified with no excessive concentration in any particular risk.

The PRS Guidelines permit a wide universe of investable instruments including the following:

(i) Transferable securities** in an eligible market;

(ii) Cash, deposits and other money markets instruments;

(iii) Units/shares in collective investment schemes;

(iv) Derivatives; and

(v) Real estate.

** Transferable securities are equities, debentures and warrants.

6.4 Investment limits

The investment limits under this section do not apply to the securities issued or guaranteed by the Government or Bank Negara Malaysia.

(a) Non-specialised fund

The investment limits and restrictions are detailed in Schedule A and A1 of the PRS Guidelines which are as set out below.

(i) <u>Exposure limits</u>

- The investments in unlisted securities cannot exceed 10% of the fund's NAV.
- The investments in real estate cannot exceed 15% of the fund's NAV.

(ii) Investment spread limits

	Maximum percentage of fund's NAV
Single issuer – ordinary shares	10
Single issuer – transferable securities and money market instruments	15
Single institution – deposits	20
Single counterparty – OTC derivatives	10
Single counterparty – structured products	15**
Investment on transferable securities, money market instruments, deposits, OTC derivatives and structured products with single issuer – aggregate exposure	25
Single collective investment scheme	20
Any group of companies – transferable securities	20

**The limit is waived for structured products if the counterparty has a minimum long-term rating provided by acceptable rating agency that indicates strong capacity for time payment of obligations and the product has a capital protection feature.

(iii) Investment concentration limits

	Maximum percentage of total issuance by a single issuer
Transferable securities other than debentures	10
Debentures	20
Money market instruments	10
In any one collective investment scheme	25

(b) Bond/fixed income fund

(i) Investment spread limits

	Maximum percentage of fund's NAV
Single issuer – debenture	20
Single issuer – highly rated debenture	30**
Single issuer – aggregate exposure	30
Any group of company – debenture	30

** The single issuer limit may be increased to 30% if the debentures are rated by any domestic or global rating agency to be of the best quality and offering highest safety for timely payment of interest and principal.

(c) Cash management fund

A cash management fund invests primarily in short-term debentures, money market instruments and short-term deposits.

(i) Exposure limits

	Percentage of fund's NAV invested
"Permitted investments"	Minimum 90%
Investments with maturity less than 365 days	Minimum 90%
Investments with a maturity between 365 and 732 days	Must be less than 10%

(ii) Investment spread limits

	Maximum percentage of fund's NAV
Single issuer – debenture and money market instruments	20
Single issuer – highly rated debentures and money market instruments	30
Single financial institution – deposits	20
Single group of companies – debentures and money market instruments	30

(iii) Investment concentration limit

	Maximum percentage of total issuance by a single issuer
Debentures	20
Money market instruments	20
Collective investment scheme	25

(d) Fund of funds

A fund is one that invests all its assets in other collective investment schemes and hence, all its assets must comprise units/shares in other funds. A fund of funds must not invest in other fund of funds, feeder funds or any sub-fund of an umbrella fund which is a fund of funds or feeder fund.

(i) Investment spread limits

A fund of funds must invest in at least five collective investment schemes at all times and the value of a fund's investment in units/shares of any collective investment scheme cannot exceed 30% of the target fund's NAV.

(ii) Investment concentration limit

A fund's investment in a collective investment scheme must not exceed 25% of the units of any single collective investment scheme.

(e) Feeder fund

A feeder fund invests all its assets into a single collective investment scheme and thus must only hold units/shares of that single scheme. The feeder must adhere to the requirements stipulated under Schedule A – Appendix III, in the PRS Guidelines.

(f) Breach of investment limits

The fund manager must ensure that the investment limits and restrictions are complied with at all times based on the most up-to-date value of the fund's assets.

A 5% allowance in excess of the limits and restrictions is permitted where such breaches are caused by the appreciation or depreciation of the fund's NAV caused by a change in market valuations or a repurchase of units or a payment out of the fund.

When the fund is in breach of the investment limits, the fund manager must not make any purchases that will aggravate the breach situation and must take the necessary steps to correct the breach within a reasonable time but not more than three months is allowed for remedial action.

6.5 Measuring performance and returns

It is important that the members are able to assess the performance of a fund under the PRS as it allows the member to make informed decisions on whether to stay invested with a current fund or to make a switch into another fund or for that matter another PRS altogether.

Fund performances are available in the disclosure documents and annual and interim report of the funds under the Scheme.

(a) Average total return

The average total return is a standard measure of performance for unit trusts and funds. It measures the total return for a measurement period (usually a year) by taking both the income distribution (dividends) and the change in the NAV per unit of the fund (the capital gains).

The formula (%) is given as:

$$\frac{\text{(NAV end period minus NAV beginning period) + Dividends}}{\text{NAV beginning period}}$$

An example with illustrate the point

	NAV (1 Jan 20X1)	NAV (31 Dec 20X1)	Dividends paid (20X1)
Fund A	RM1.00	RM1.02	RM0.05
Fund B	RM1.00	RM1.04	RM0.02

Average total return for Fund A = ((RM1.02 - RM1.00) + RM0.05) / RM1.00 = 7% for 20X1

Average total return for Fund B = ((RM1.04 - RM1.00) + RM0.02) / RM1.00 = 6% for 20X1

(b) Compounded annual return

Another method to measure performance is to use the compounded annual return (CAR). The CAR measure is useful for comparing fund performances that differ in holding period. For example, how do you compare a fund where your investment grew from RM1,000 to RM1,300 in five years against another where your RM1,000 grew to RM1,700 in 10 years? In the first instance, the CAR rate is 5.39% while in the second, it is 5.45%. The CAR standardises the time dimension so that returns over different periods can be compared.

There are drawbacks to this method as it assumes that the returns are compounded at the same rate for each period (year). Another drawback is that this focuses on the return element without looking at the risk element (the volatility of returns). The third drawback is that the CAR measure must be put into context when assessing performance. Say Fund A has a CAR of 9.50% over the past 15 years whereas Fund B has a CAR of 10% over the last two years. Is Fund B superior to Fund A? Not necessarily. The longevity of Fund A and their ability to produce returns over 15 years (over many market cycles) is certainly a good attribute to have even if it has a lower CAR over the last two years.

Nevertheless, even with these drawbacks, the CAR is a useful tool to have in assessing fund performances.

(c) Income distribution

Another aspect to consider is the income distribution. Two funds may provide the same average total return but one fund pays a higher dividend. If a member has some short-term liquidity preference, then the higher dividend income would appeal to the member even if both the fund returns are the same.

For the PRS investor, any dividend income must be paid out in the form of units and withdrawal of the dividend must be deferred until the member has reached retirement age. This is the same for dividends declared by the EPF which is also not accessible by the EPF member until he reaches retirement age.

PRACTICE QUESTIONS

Question 1

With regard to the suitability assessment process conducted by a PRS Consultant, what is the MAIN purpose of seeking information on the member's investment objectives?

(A) To ascertain the member's financial knowledge

(B) To ascertain the member's risk profile and needs

(C) To ascertain a suitable PRS Providers for the member

(D) To ascertain the member's appreciation of the potential returns of the PRS funds

[Answer: B]

Question 2

Question 2 is based on the scenario below:

	Average yearly returns for the past 5 years	Average annual volatility for the past 5 years
JPM Global Bond Index	6.75%	6.3%
Fund A	6.80%	6.2%
Fund B	6.75%	7.3%
Fund C	7.85%	6.2%
Fund D	7.75%	9.0%

The Investment objective of the Private Retirement Scheme (PRS) is to track the returns and volatility of the JPM Global Bond Index over a 5-year period.

Which of the funds would be considered relevant, consistent and appropriate to the investment objectives of the PRS?

(A) Fund A

(B) Fund B

(C) Fund C

(D) Fund D

[Answer: A]

Question 3

Investments of a cash management fund may include ________________.

(i) a corporate debenture maturing in three years

(ii) Cagamas Notes maturing in 20 months

(iii) a six-month MYR deposit with a foreign bank in Kuala Lumpur

(iv) a bank debenture maturing in seven months

(A) (i) and (ii) only

(B) (i), (ii) and (iii) only

(C) (ii), (iii) and (iv) only

(D) (iii) and (iv) only

[Answer: C]

CHAPTER 7

PRIVATE RETIREMENT SCHEME DISTRIBUTOR AND CONSULTANT

Learning objectives

Only a PRS Provider who has been approved by the SC can establish, offer or provide a PRS or hold himself out as establishing, offering or providing a PRS.

This chapter discusses the role of the PRS Distributor and Consultant in the distribution of the PRS and the regulation of the distribution channel. It also covers the guidelines governing the behaviour of the PRS Consultant when servicing clients and rendering investment advice.

At the end of this chapter, you should be able to:

- describe why the PRS distribution channels are regulated;
- explain the different types of corporations and their representatives who are involved in the distribution of the PRS;
- list the eligibility requirements of a PRS Distributor;
- recognise that PRS Distributors and Consultants who do not adhere to good conduct will face disciplinary proceedings;
- acknowledge the value of good service to the PRS member;
- recall the factors to consider when rendering investment advice to the PRS member; and
- cite the guidelines on marketing of the PRS.

7.1 Regulating the distribution channel

PRS Distributors are entities such as financial institutions that enter into agreement with PRS Providers to market and distribute the PRS to individuals and employers. The individuals representing the PRS Distributor are PRS Consultants who are required to be registered with the Federation of Investment Managers Malaysia (FIMM). It is essential that the distribution channel and the PRS Consultant are regulated to ensure–

- high standards of conduct; and
- the delivery of reasonable advice or basis for recommendations to individuals and corporations.

7.2 Licences for dealing in PRS

The requirement to obtain a Capital Markets Services Licence (CMSL) for dealing in PRS is only applicable to a Principal who deals in PRS, including–

(a) an approved PRS Provider under the CMSA;

(b) unit trust management companies;

(c) a CMSL holder licensed for fund management;

(d) a CMSL holder licensed for financial planning distributing PRS following a financial plan;

(e) a CMSL holder licensed for dealing in securities;

(f) a CMSL holder licensed for dealing in securities restricted to unit trusts;

(g) an insurance company licensed under the *Insurance Act 1996*;

(h) financial advisers licensed under the *Insurance Act 1996*; and

(i) any other person as the SC deems appropriate.

With reference to the *SC Licensing Handbook*, agents and employees of a holder of a CMSL for dealing in PRS or of a registered person dealing in PRS will not be required to hold a *Capital Markets Services Representative's Licence* (CMSRL). All PRS Distributors and their agents and employees are however, required to be registered with a body approved by the SC, i.e. the FIMM.

Further, these agents and employees must pass the examinations for persons dealing in PRS or any other qualification recognised by FIMM in order to carry out their dealing in PRS.

7.3 Registration of the PRS Consultant

(a) Eligibility requirement

Eligibility requirements for a person to be registered as a PRS Consultant is set out in Appendix A of the *Guidelines on Registration of Private Retirement Scheme Distributors and Consultants* (FIMM Guidelines) which includes the following-

(i) Be at least 21 years of age;

(ii) Has passed the PRS Examination (unless exempted by FIMM) ;

(iii) Has not been convicted of any criminal offence either locally or abroad;

(iv) Has not been censured or reprimanded by any professional or trade body;

(v) Has not been denied or disqualified from memberships in any professional or trade body; and

(vi) Is not an undischarged bankrupt or subjected to any bankruptcy proceedings or has failed to meet any judgment debt.

(b) Registration

Any eligible person intending to register as a PRS Consultant must make an application through a PRS Distributor who will make the application to FIMM in the format and manner required. The PRS Distributor is responsible for ensuring the eligibility of any applicant and the accuracy and completeness of information and documents furnished by the applicant.

PRS Distributors must ensure that their PRS Consultants observe the following:

(i) A PRS Consultant must only represent one Principal;

(ii) A PRS Consultant must only deal in the PRS of his Principal or those distributed by his Principal and cannot make arrangements to distribute PRS of other PRS Distributors or those distributed by other PRS Distributors;

(iii) A PRS Consultant of a PRS Provider or an Institutional PRS Adviser who holds a CMSRL to carry out the regulated activity of financial planning as defined in the CMSA and intends to represent a Corporate PRS Adviser must duly terminate his registration as the PRS Consultant of the PRS Provider before applying to register as a PRS Consultant of the corporate PRS Adviser.

Institutional PRS Advisers must ensure that only their fulltime employees may register as PRS Consultants. This restriction does not apply where the Institutional PRS Adviser is a unit trust management company or a licensed insurance company or a registered *takaful* operator.

Corporate PRS Advisers must ensure that only their fulltime employees who hold a CMSRL for regulated activity of financial planning may register as PRS Consultants.

(c) Duration and reregistration

The registration of a PRS Consultant will continue unless and until it is either terminated or revoked, provided that the PRS Consultant settles in full all necessary fees as prescribed by FIMM in the relevant manual.

A PRS Distributor may reregister the following PRS Consultant or former PRS Consultant in the format and manner set out in the relevant manual, including where–

(i) A PRS Consultant who has changed his agency or employment status with the PRS Distributor;

(ii) A former PRS Consultant who resigned from the PRS Distributor;

(iii) A former PRS Consultant whose registration was not renewed by PRS Distributor whereby the non-renewal was not due to any misconduct or non-compliance of the former PRS Consultant; and

(iv) A former PRS Consultant of another PRS Distributor.

Any former PRS Consultant who has left the PRS industry for more than three years must sit for the PRS examination if he intends to reregister as a PRS Consultant.

(d) Revocation, suspension, termination and resignation

In the event a PRS Consultant resigns from his Principal or is terminated by his Principal, the Principal must–

(i) require the PRS Consultant to surrender his FIMM authorisation card; and

(ii) update the registration status of the PRS Consultant in the records of the FIMM.

The FIMM may suspend or revoke the registration of a PRS Consultant in the event that–

(i) the PRS Consultant ceases to be eligible for whatever reason;

(ii) the relevant CMSRL of the PRS Consultant is suspended or revoked by the SC;

(iii) the PRS Consultant fails to comply with the relevant rules, guidelines, by-laws, codes, directive or standards issued by the FIMM, regulations or guidelines issued by the SC, securities laws or such other applicable laws;

(iv) the SC issues a directive to the FIMM to suspend or revoke the registration of the PRS Consultant; or

(v) any information or declaration in any statutory declaration provided by the PRS Consultant for purposes of his registration with the FIMM is found to be false, in part or as a whole.

The registration of a PRS Consultant will lapse in the event that–

- the registration of his Principal is revoked;
- the registration of his Principal is suspended; or
- his Principal ceases operations.

7.4 Code of ethics and standard of professional conduct

(a) General

This section borrows heavily from the Code of Ethics and *Standards of Professional Conduct for the Unit Trust Industry* (the Code) issued by the FIMM. Given that the PRS Distributor and Consultant are also registered with the FIMM, they should also adhere to this code of ethics and standards of professional conduct.

The Code sets out the general principles and minimum standards of good practices for all who are registered with the FIMM and is intended to guide the conduct of business affairs in the best interest of members of the PRS and the PRS industry in general.

(b) Code of ethics

(i) <u>Professionalism</u>

PRS Distributors and Consultants should conduct their dealings in a professional manner ensuring that they themselves are knowledgeable in all aspects of the PRS and the funds that they are marketing and that they are in compliance with the best business practices. The PRS Distributor and Consultant should behave with dignity and courtesy to all persons whom they come in contact with in the course of rendering their service especially to the members and other persons in the PRS industry.

(ii) Honesty, dignity and integrity

The PRS Distributor and Consultant should at all times act with honesty, dignity and integrity, and should conduct and encourage others to conduct themselves in a professional and ethical manner that will bring credit to themselves and the PRS industry.

The PRS Distributor and Consultant must also maintain a high standard of personal integrity and not engage in activity that may bring discredit to the industry. In particular, the PRS Consultant must not misrepresent–

- his qualifications or that of the PRS Provider he represents;
- the funds and its characteristics offered by the PRS Provider he represents; and
- the past investment performances of the funds or Scheme he is marketing.

Omission of a material fact is considered a dishonest conduct. A material fact is one, which if made known to the member, will cause the member to discern that the fund or PRS is materially different from what was represented to him.

(iii) Confidentiality

The PRS Distributor and Consultant must maintain the confidentiality of information of PRS members and not disclose any personal or financial information except where expressly authorised or where such disclosure is required by law.

(iv) Fair dealing

The PRS Distributor and Consultant must deal fairly and reasonably with the member and must disclose any risks to the transaction, any conflict of interest that may arise and other relevant information including fees and charges, necessary to make the transaction fair to the member.

Fair dealing requires impartiality, intellectual honesty and disclosure of conflicts of interest. In simple terms, fair dealing is treating others in the same way that you want to be treated. Overly aggressive and offensive sales practices and techniques should be avoided.

(v) Good faith

The PRS Distributor and Consultant should always act in good faith and with the best of intentions. The member should be treated with respect and be given full disclosure of all pertinent information to make a good investment decision.

(vi) Competence

The PRS Distributor and Consultant should maintain the necessary knowledge and skill to serve the member competently in the areas that the PRS Distributor is engaged in.

(vii) Acting with due care, skill and diligence

The PRS Distributor and Consultant should conduct all his dealings with every care, skill and diligence. In particular, the PRS Distributor and Consultant must–

- ensure that the funds and Scheme are suitable to the needs and not beyond the resources of the member;
- take all reasonable steps to provide the member with comprehensive and relevant information for him to make a balanced and informed decision;
- only provide information that the PRS Distributor and Consultant are competent to deal with and to seek specialists' advice where appropriate;
- make every effort to convey information in the correct context so as not to be misconstrued by the member. Overly technical explanations or too brief an explanation should be avoided as they can cause confusion and misunderstanding;
- not omit any material facts nor make exaggerated and misleading statement or claims or forecasts or future events; and
- when making comparisons with other Scheme and funds, make clear the different characteristics and risk profile of each scheme.

(viii) Prompt, efficient and continuous service

The PRS Distributor and Consultant should try to provide the member with prompt, efficient and continuous service. In particular, the PRS

Distributor and Consultant should always be ready to answer any queries the member may have on the performance and management of PRS and funds under the Scheme.

(c) Standards of professional conduct

(i) Compliance with laws

The PRS Distributor and Consultant should maintain knowledge of and comply with the CMSA, the PRS Regulations and PRS Guidelines and all laws and rules governing the PRS industry. The PRS Distributor and Consultant should co-operate openly with the relevant authorities and disclose all reasonable and appropriate information.

(ii) Marketing and distribution with the disclosure document

The PRS Distributor and Consultant must provide the potential member of the PRS with the Product Highlights Sheet on any introductory marketing meeting. The Product Highlights Sheet is a summary of the disclosure document and would provide the potential member with important information about the PRS and funds within the Scheme.

On further exploratory discussions with the member, the disclosure document with the application form must be provided to the member before the potential member contributes and attention drawn to the importance of the document. The potential member is advised to read and understand the disclosure document before applying to invest in the funds of the PRS.

(iii) Adequate explanation of the nature and characteristics of the PRS funds

The PRS Distributor and Consultant should adequately explain the nature and characteristics of the PRS and the funds within the PRS. To achieve this end, the PRS Distributor and Consultant must–

- make clear the essential attributes of investing in the PRS, including the investment objectives of the funds, the risks of investing in these funds, the charges and fees of the funds, forward pricing, the minimum allowable amount per fund and the tax implications of the PRS;
- draw attention to the unique restrictions of investing in the PRS including the long-term nature of the scheme and the

tax penalty for pre-retirement withdrawal of funds from sub-account B; and

- ensure that the member understands what he is committing himself to.

(iv) Advertisement and promotional materials

The PRS Distributor and Consultant must only use advertisement and promotional material that have been approved by the PRS Provider in accordance with the guidelines mentioned below in paragraph 7.7(b) and other relevant guidelines issued by the SC.

(d) Disciplinary proceedings

In order to maintain the high standards of professional conduct, any PRS Distributor and Consultant who have breached the provisions of the Code shall be subject to appropriate disciplinary proceedings. Actions that may be taken include a private reprimand, a public reprimand, a fine, a suspension or revocation of registration to the FIMM.

7.5 Servicing the PRS member

In the unit trust industry, most new business comes from repeat business with satisfied existing clients or through their network of recommended contacts. It can be inferred from that experience, that a client's satisfaction is paramount and should be the basis of any service rendered. The PRS industry is no different as it also involves contact between potential members and the PRS Distributor and Consultant who will be the point person for any PRS funds. Thus service should be focused on satisfying the needs of the member so that it becomes the basis of ongoing contributions by members. The PRS Distributor and Consultant should note that contributions are voluntary and can stop any time if the member is not satisfied with the performance of the PRS Distributor and consultant or the funds within the PRS.

One important part of servicing the member is to know your products well. The PRS Distributor and Consultant should be well versed with how the Scheme functions as well as the characteristics of the funds within the Scheme. knowledgeable PRS Distributor and Consultant will be able to assess the needs of the members and will be able to advise the members adequately by matching the appropriate funds to the member's requirements and resources.

Knowledgeable PRS Distributors and Consultants will also be able to manage the expectations of the members. Studies have shown that delivering what the clients thought they were investing in i.e. the funds as described in the disclosure document with no unexpected investment return surprises will enhance client satisfaction. Thus it is essential that there is no exaggeration during the marketing pitch and the PRS Distributor and Consultant explain the risks of the various funds of the PRS as well as why certain funds are recommended to the member. If the potential member or existing PRS member can internalise the reasons for investing in the Scheme then retention rate would be high and the PRS member has a high chance of being satisfied with the PRS products.

Unlike the unit trust, the PRS can be offered to employers who make contributions on behalf of its employees. In this regard, employers may choose one or more PRS by entering into agreement with the relevant PRS Providers to give access to such schemes to its employees. It is important that PRS Distributors are able to advise such employers and that the PRS Consultants should be able to advise and service the employees and help them choose the appropriate fund. Where employees do not make a fund selection, contributions can be channelled to the default option of that PRS Provider.

7.6 Rendering investment advice

The following are general guidelines for the PRS Consultants to consider when they are rendering investment advice in relation to PRS funds:

(i) Client's investment goals

The PRS Consultant should understand his client's investment goal i.e. does the PRS member seek to preserve capital or want to earn relatively high investment returns.

(ii) Client's investment horizon

The PRS Consultant should identify the client's investment horizon as it will influence portfolio construction.

- If retirement is imminent, then the client may opt for some relatively stable and conservative investments like bonds and money market funds.
- If retirement is far off and there is an opportunity to develop an income stream, then the client may consider investing in higher-risk instruments like emerging market equities that can potentially yield higher returns.
- If retirement is some years away, the client may consider investing in a balance investment portfolio of bonds and equities.

(iii) Client's investment portfolio

The PRS Consultant should find out the composition of the investment portfolio currently held by the PRS member so that the PRS Consultant can recommend funds that are appropriate and complementary to the existing portfolio. For example, a member may have his entire portfolio in unit trusts that invest in Malaysian equities. The PRS Consultant may advise the PRS member to consider investing in a PRS fund that is predominantly fixed income or in international equities for portfolio diversification.

(iv) Age and personal circumstance

The age of the PRS member plays a huge role in portfolio construction and advice. The younger the member, the more volatility of investment returns can be tolerated in the short term in the search for long-term capital appreciation. A younger member should consider more equity exposure in his portfolio while an older member may want to consider more fixed income instruments as his investment horizon is markedly shorter and he cannot afford so much short-term volatility in returns.

Personal circumstances may render the age issue moot. A person may be young but have high income needs (e.g. dependent parents, etc.) or an older member may have little need for current income. The PRS Consultant must take note of personal circumstances in advising the member.

(v) Risk tolerance

An important aspect of portfolio construction is taking into consideration the risk tolerance of the PRS member. A young PRS member may have very little tolerance for short-term volatility of returns while an older PRS member may be just the opposite. For example, someone who has just started work may need to accumulate assets quickly with a specific aim in mind (e.g. buy a house to live in with his family or start a new business) and therefore, this individual will not be able to tolerate volatile equity returns given that his particular investment horizon is relatively short. On the other hand, someone in their 50s may have surplus cash for multi-generational investing (i.e. he will leave the results of his investing to his children). The investment horizon is long and the risk tolerance will be considerable.

It is therefore imperative that the PRS Consultant understands the needs and risk preference of the member as not all members are opting for maximum long-term return and may have some shorter-term investment goals.

(vi) Highlighting the key risks

The PRS Consultant must highlight key risks of each fund under the Scheme. The key risks can be found in the Product Highlights Sheet as well as the disclosure document. The PRS Consultant must make the member realise that risk of capital loss in any investment is a commonly occurring event and there is always a chance of significant capital loss in their investment.

(vii) Retirement planning

The PRS Consultant should do a retirement assessment for the PRS member. A simple example of retirement needs assessment can be found under Chapter 1, section 1.1 (a) of this study guide. The PRS Consultant must take into account the specific needs of the member such as financial commitments, current savings in the EPF and banks, as well as other investments. With a personalised retirement assessment, the PRS Consultant would be able to help the member with retirement planning with respect to the type of funds that are suitable as well as the quantum of contribution needed each year to achieve the retirement goal.

The PRS Consultant must also be able to explain the tax advantages and other advantages of the PRS (e.g. lower commissions) compared to other retirement products.

The PRS Consultant should also provide an explanation of the risk parameters of the different funds and the various categories of risk profiles that the member may fall under i.e. a risk-adverse investor, a risk-neutral investor or a risk-seeker investor. By matching the risk profile of the member against the risk profile of the various funds, the PRS Consultant would be able to recommend funds that are suitable for the member.

7.7 Marketing of PRS

(a) Adhere to the code of ethics and standards of professional conduct

The PRS Distributor and Consultant must adhere to the code of ethics and standards of professional conduct mentioned under section 7.4 of this study guide.

Specifically the PRS Distributor and Consultant must–

(i) behave in a professional manner;

(ii) act with honesty, dignity and integrity;

(iii) maintain confidentiality;

(iv) deal fairly with the PRS member;

(v) act in good faith;

(vi) be competent in their advisory capacity;

(vii) act with due care, skill and diligence;

(viii) provide prompt, efficient and continuous service to the member;

(ix) be compliant to all laws that govern the PRS industry;

(x) use appropriate designation or titles;

(xi) market the PRS using the disclosure document and Product Highlights Sheet; and

(xii) explain fully the nature and characteristics of the PRS funds.

(b) Adhere to the advertising and promotional material guidelines

The PRS Distributor must also adhere to the advertising and promotional materials guidelines that are set out in *Guidelines on Unit Trust Advertisement and Promotional Materials* and any other guidelines issued by the SC.

PRACTICE QUESTIONS

Question 1

Private Retirement Scheme Consultants who breach the provisions of the code of ethics and standards of professional conduct will face actions, including ________________.

(i) imprisonment

(ii) a private reprimand

(iii) a revocation of registration with the Securities Commission Malaysia

(iv) a suspension of registration to the Federation of Investment Managers Malaysia

(A) (i) and (iii) only

(B) (ii) and (iv) only

(C) (i), (ii) and (iv) only

(D) (ii), (iii) and (iv) only

[Answer: B]

Question 2

What are the factors that a PRS Consultant must consider when rendering investment advice to a Private Retirement Scheme member?

(i) The personal circumstances of the member

(ii) The risk tolerance of the member

(iii) The near-term market outlook

(iv) The investment recommendations of the PRS Provider

(A) (i) and (ii) only

(B) (i), (ii) and (iii) only

(C) (i), (ii) and (iv) only

(D) (iii) and (iv) only

[Answer: A]

Question 3

With regard to the code of ethics, the omission of a material fact when dealing with a Private Retirement Scheme member is covered under the code of ________________.

(A) confidentiality

(B) fair dealing

(C) honesty, integrity and dignity

(D) prompt, efficient and continuous service

[Answer: C]