Executive Summary

The Government of Malaysia, with the financial support of UNDP, undertook extensive studies over the period from 1994 to 1996 into the strengths and weaknesses of the system of social protection and recommended a series of improvements for the future development in this increasingly important sector. This UNDP financed project concerns two of the major priorities, the design of a social insurance pension scheme and extension of social security protection to self-employed workers.

In the case of pensions, the proposed change of principle from the defined contribution system for protection against long-term risks in the form of the individual Accounts 1 in the Employees Provident Fund (EPF) to a defined benefit pension scheme which is designed to pool risks and finances constitutes a far-reaching change and raises a number of issues. The new scheme, termed the Employees Pension Scheme (EPS), will provide pensions throughout the contingencies of old-age, survivorship and invalidity which, by utilising social insurance principles, will ensure adequate standards of income protection in conformity with relevant ILO Conventions\(^1\). The ability of the scheme to meet social needs is demonstrated by the proposed provisions for transitional pensions which will ensure that persons who are already too old on the starting date (A-day) to complete the qualifying period of 180 months for retirement pension by the normal retirement age will have opportunities to obtain pensions through shorter contribution conditions. The basic pensions strategy is to achieve reasonable standards of income protection but, by limiting the pension replacement levels, to leave room for the promotion of voluntary supplementary provision in accordance with government policies for the development of the insurance industry.

Several important issues arise under this entirely different approach to income replacement in retirement, notably the normal retirement age, the financial system, adjustments of pensions, and the conversion of EPF Account 1 balances for pension purposes. Pension age is an extremely important factor in pension costs, and tends to influence the actual retirement ages of employees. It was agreed at the National Seminar on Converting the EPF to a Pension Scheme, that age 55, currently the qualifying age for lump-sum withdrawals from Account 1, was no longer appropriate under the new system, considering increasing life-expectancy and plans to raise the civil service retirement age, and should be raised This report contains the cost estimates for alternative ages of 60 and 58 years, as identified at the above seminar, for the normal retirement age in a flexible system allowing retirement between ages 55 and 65, with appropriate pension reductions for early retirement and increases for continued insurable employment beyond pensionable age.

Unlike the EPF, which is a fully-funded defined-contribution scheme, the EPS may adopt partial funding strategies, which implies inter-generational transfers and eventual raising of the initial contribution rate. Cost projections have been made for the different pension formulae, which were discussed at the National Seminar, and the funding options within the 13.8 per cent of earnings contribution rate appertaining to EPF Account 1, as the basis for a final decision on the standards of the EPS. This comprises also other elements on which a consensus was reached, including the semi-automatic method of adjustment of pensions in payment, and the principle of voluntary conversion of part or all of individual EPF Account 1 balances into pension credits for the purposes of qualifying for and enhancing pensions (qualifying only for the transitional pensioners) at the time of claiming benefit.

Another important aspect is that responsibility for invalidity and survivors' pensions will be transferred from SOCSO to EPS, with appropriate provision for the maintenance of acquired rights and rights in the course of acquisition, as also SOCSO's 1 per cent contribution rate for Invalidity benefits. This underlines the fact that the introduction of the EPS will constitute a major step

forward in the development of a unified and enhanced system of long-term income protection in Malaysia.

The self-employed number about 1.7 millions and with their dependants constitute a significant proportion of the population which is currently outside the scope of social security protection, despite the interest in joining schemes expressed by representatives of different types of self-employed workers. In common with other East Asian countries, Malaysia has accorded priority to extending coverage in the self-employed sector having brought all employees into the social security system A scheme has been designed which adapts the SOCSO system of invalidity, survivorship and employment injury insurance (EI) to the special characteristics of the self-employed The proposed main differences from the employees' scheme are:

- the system of employment injury protection should exclude temporary disablement benefit and assessments of permanent disablement of 20 per cent or less;
- the contribution rates should be 1 per cent of earnings for the employment injury and 1 per cent for invalidity and survivorship protection; and
- the new earnings schedules should commence at the level of wage-class 7 in order to protect the finances.

The basic assumption is that the obstacles to the inclusion of self-employed workers, especially the difficulties in determining earnings for contribution purposes and in enforcing the scheme to counter adverse selection, will be overcome by effective administrative standards in SOCSO and the proposed phased implementation strategies. It is, however, of paramount importance that the responsible government authorities and SOCSO determine whether these are adequate safeguards against the risks involved, especially in the inclusion of employment injury protection albeit in modified form.

The other main design concepts are:

- all types of self-employed workers should participate in the same scheme;
- the prescribed age and other conditions for membership of employees, except annual rather than monthly earnings limits, should apply to the self-employed, and periods of insurance as employees and as self-employed should be linked for all purposes; and
- the finances should be maintained separately from the current scheme by establishing autonomous funds to receive the income derived from self-employed membership and to meet all expenditure on benefits and administration.

The available data on the self-employed suggest that, judging from the experience of the current scheme, the fact that the self-employed are older and predominantly male, may result in a higher claims incidence and eventually require raising of the contributions rates. Careful monitoring of the scheme's experience will be necessary, which is envisaged as essential for all aspects of implementation. This will be facilitated by starting with carefully selected pilot schemes in which occupational groups are selected to provide a wide range of experience in order to build up capacities to extend coverage as rapidly as possible. The key to efficient administration will be to enact a series of new regulations, and establish arrangements under this framework with various organisations concerned with farmers, fishermen, professionals and other types of self-employed workers for co-operation in administrative procedures, especially registration and the collection of contributions. The aim will be to attain economies of scale as similar as possible to those which form the basis for SOCSO's current administrative system.

One key factor will be the effectiveness of proposed procedures for assessing contribution liabilities on the basis of earnings declarations made to Inland Revenue, which could ensure that self-employed workers are adequately insured in respect of actual earnings and the scheme's finances are on a sound footing. It is, however, proposed to experiment in pilot schemes with self-selection of earnings-classes in order to compare and determine which best meets these requirements. This approach was suggested by the National Seminar on the Coverage of the Self-Employed Sector. This endorsed the concepts and principles embodied in the proposed scheme, and
expressed support for the proposed system of co-operative arrangements between responsible bodies and organisations in the implementation of this innovative scheme for the benefit of the self-employed, and the further development of social security protection in Malaysia. The discussions held at the National Seminar have set out the key issues on which the further steps need to be taken. The ILO stands ready to provide further technical expertise to assist in these follow-up actions.