Retirement Planning: Simpanan Shariah — to switch or not to switch?

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The Employees Provident Fund’s (EPF) new Simpanan Shariah opens for registration on Aug 8. Its members, irrespective of race or religion, will have the option of migrating from the conventional account to this shariah-compliant one.

The decision to migrate, however, is a critical one because once they have transferred to this account, there is no turning back. “The EPF is a long-term fund and the prohibition on reversal is to avoid any attempt to speculate and arbitrage on the dividends between the conventional and shariah accounts,” says Ja’afar Rihan, head of EPF’s Simpanan Shariah department.

Unlike the conventional account, which has a guaranteed dividend of 2.5% per year, Simpanan Shariah does not have a guaranteed dividend. “The dividend rates will be based on the portfolio performance of shariah-compliant investments,” Ja’afar points out.

As the migration to Simpanan Shariah is irreversible and the returns are not guaranteed, financial planners and industry experts recommend adopting a wait-and-see approach before jumping on the bandwagon. EPF members are also advised to assess the performance of the account, which will have an initial fund size of RM100 billion when launched in January next year, before making a decision.

Robert Foo, managing director of MyFP Services Sdn Bhd, says although EPF has been good at managing the pension fund, it does not have a track record for its shariah-compliant account. “The prohibition on switching back [to the conventional account] is very inflexible for members. They will be locked in the shariah investment account and not be able to do anything if it does not perform. This may cause them to have a smaller nest egg. Thus, they should wait and see how the initial allocation performs because at the end of the day, we are not sure how Simpanan Shariah will fare,” he adds.

Kelly Wong, CEO of Blueprint Planning International Sdn Bhd, says EPF members should not make any hasty decisions. “We are talking about the contract for the number of years that you have until your retirement. If you are comfortable with the dividends you are receiving now, I would advise you to stay with the conventional account. You have the option of switching later, should you feel the need, so you might as well wait and see if any new mandates come along or any new information is released that will convince you to switch.”

Expected returns

According to the EPF, the variance in the overall returns between the conventional account and Simpanan Shariah is expected to be about 0.5% or 50 basis points over a 20 to 30-year investment horizon.

A shariah fund is known to perform well in a volatile economy. But does it perform well over a longer investment horizon?

Akmal Hassan, managing director of Asian Islamic Investment Management Sdn Bhd, says although historical performance does not indicate future performance, it should be taken into consideration. He points out that in the short term — over three and five years — the FTSE Bursa Malaysia Hijrah Shariah outperformed the FBM KLCI by
2.71% and 3.33% respectively.

However, over the long term (10 years), the FBM KLCI outperformed the shariah index — but only by 1.16%. “By referring to the broader equity and money markets, we can conclude there is some variance in the short-term period where the shariah account may outperform the conventional one. However, over the long term, their performance will be quite close to each other,” says Akmal.

Datuk Dr Mohd Daud Bakar, founder and group chairman of Amanie Advisors Sdn Bhd, says since the performance of equity-based funds are cyclical, it will be a challenge for the EPF to ensure that its members, both in the conventional and shariah accounts, receive the same amount of returns. Therefore, he says the EPF should diversify its shariah-compliant investment account and invest in other asset classes to make sure it is able to absorb the market arbitrage.

“Islamic funds outperform during a financial crisis, but it is not easy to outperform throughout the years. You cannot be expecting bear markets all the time. In fact, you also cannot expect the Islamic fund to go up during a bear market because the Islamic fund is about the real economy — it is about the season, weather, conflict, war, oil and gas. There is more than one factor that can make the market bearish,” says Mohd Daud.

Whether Simpanan Shariah performs depends on the strategy of the investment, he points out. However, Mohd Daud believes that the investment team of Simpanan Shariah has the required expertise to manage the expectations of members and beef up performance.

“At the end of the day, you have to fall back on the expertise of the manager to pick the right shariah-compliant assets at the right time to outperform the conventional fund manager using the same maths of when and how much to buy and when to exit. They will have to work extra hard. But this is their core strength. They have committed to it, so they have to deliver,” he says.

According to Ja’afar, a shariah advisory committee (SAC) has been formed to oversee all operational, investment and governance aspects of Simpanan Shariah. The SAC will also recognise shariah investment products regulated or approved by Bank Negara Malaysia and the Securities Commission Malaysia.

The bottom line

When it comes to investing, it depends on one’s investment objective, risk tolerance and investment horizon. Akmal says the decision to switch to Simpanan Shariah would depend on a member’s investment objective.

“Say, a member is a Muslim and his investment objective is to only invest in shariah-compliant assets. When given the option of choosing between a conventional or shariah account, of course, he will choose the shariah option, regardless of other considerations such as risk or return.”

Mohd Daud says at this stage, it is more about compliance than performance. Therefore, members who are thinking about switching will be more than happy if they are able to receive more or less the same returns that the conventional account gives. These members will be convinced if the shariah-compliant account performs as well as its conventional peer, he adds.

“Before this, it is equal to everyone. Now, you have something extra — something that is close to your belief. The credentials of the EPF are the same, the corporate culture is the same. But there could be some challenges with regards to asset selection and allocation. This is up to the management. So, you have to be engaged with the management to ensure it is not only shariah-compliant but also a good performing account at the end of the day,” he says.
Although the EPF does not make any recommendations and the decision to switch is entirely up to the members, Ja’afar advises them to stick to the current structure if they are not convinced.

If members are still on the fence, Blueprint’s Wong says there is no need for them to switch, since the conventional account is already 45% invested in shariah-compliant assets. “In asset allocation, we encourage shariah funds because they have been proven to be good in volatile markets. Therefore, in terms of financial planning, the EPF’s conventional investment account is quite diversified already. Once you switch to Simpanan Shariah, 100% of your assets will be shariah-compliant. Members should bear this in mind.”

MyFP Services’ Foo says it will be better for those who are unsure to stick with the conventional account. “From a financial point of view, does Simpanan Shariah fulfil something the conventional account cannot? What are the new features that allow the shariah-compliant account to have greater probability of fulfilling its mission of making sure retirees have enough money, compared with the conventional one?

“Frankly speaking, there is no difference other than the shariah label. It does not ensure there will be justice to the contributors and it does not ensure that members will have enough money for their retirement. On top of that, it is not flexible. So, I would not recommend anyone to switch.”

Having said that, Foo says those who want to switch should do so. “If you really want to switch, you can. However, you have to remind yourself that this is the savings for your retirement. You have to think about the returns, the sustainability of the savings and how secure you will be financially in your senior years. It is best to wait and see.”