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Headline	EPF's high impairment raises some questions		
MediaTitle	Focus Malaysia		
Date	04 Mar 2017	Language	English
Circulation	20,000	Readership	60,000
Section	News	Page No	1,17
ArticleSize	827 cm²	Journalist	14.7%
PR Value	RM 43,046		

Unease over EPF's soaring impairment

Did poor investments lead to impairment amounting to over RM8 bil? 17

EPF's high impairment raises some questions

Was it accounting issue or were less than ideal investment decisions made last year?

by Ng Wai Mun

THE Employees Provident Fund (EPF) raised eyebrows recently, after declaring a dividend rate of 5.7% for last year – lower than 2015's 6.4%.

The announcement was followed with the usual close scrutiny by the investment community and public.

The dividend was, among others, dragged down by significantly higher impairment, which EPF recognised last year.

Questions were raised as to why it was so high, and whether less than ideal investments led to the impairments.

EPF calculates dividends by deducting impairments and unrealised foreign exchange losses from its total realised income.

Last year, its net impairment soared to RM8.17 bil in contrast to 2015's RM3.1 bil. The provision in 2014 was at a much lower RM889 mil.

A research manager says impairment, which is an acceptable accounting practice, is basically a reduction in the value of the assets held.

"If there is a substantial reduction in the value (of one's assets), even if the company is reluctant to impair, auditors will say that the value of assets is overstated. It is all in accordance with the Malaysian Financial Reporting Standards [MFRS]," she says.

If not for the higher impairment, she says EPF members would have received a higher dividend rate.

"If impairment was unchanged at RM3 bil, dividend payout will be RM5 bil higher or about 0.8% [higher] in terms of dividend rate," the research manager says.

The dividend payout for last year was RM37 bil. With a dividend rate of 5.7%, the payout amount required for every 1% dividend rate is RM6.5 bil.

Bad decisions?

Did wrong investment decisions lead to higher impairments?

The research manager says despite operating under the same trying environment last year, Permodalan Nasional Bhd was still able to announce a higher dividend of 6.1 sen for Amanah Saham 1Malaysia for the year ended September, last year.

"There was no mention of huge impairment," she says.

The research manager pointed out that while the magnitude of the impairment is not something which EPF can control or arbitrarily determine, the much higher impairment last year suggests that less than ideal investment decisions may have been made.

"Using the FBM KLCI as a gauge, be it the index as at year-end or the average for the year, the decline in 2015 was worse than last year. Hence, there is no justification [for the impairment] to be so much higher, jumping from RM3 bil to RM8 bil," she says.

EPF says the higher provision last year reflected lower equity prices, particularly

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in the banking and oil & gas sectors in domestic and foreign markets.

Also, the KLCI, with almost 33% exposure to the banking sector, yielded negative returns for the third consecutive year, closing with -3% in returns.

EPF CEO Datuk Shahril Ridza Ridzuan and his team are under pressure to deliver better returns this year.

"If Bursa Malaysia turns around this year, the impairments will go down, and if our investment income remains stable or grows, I think we will be quite OK for this year," he said during a media briefing on Feb 20.

However, Aberdeen Islamic Asset Management Sdn Bhd CEO Gerald Ambrose offers a different view.

"The new, more stringent impairment under the international accounting rules MFRS 139 came into effect in mid-2015 only.

"Therefore the effect on the investment portfolio may inevitably be greater last year," he tells ***FocusM***.

Diversification pays off

He says EPF has been proactive in putting its eggs in a variety of baskets where 29% of its assets are now invested abroad.

Returns from these assets, he says, provided the fund protection from a weak ringgit and contributed 39% of the total returns last year.

RHB Islamic International Asset Management Bhd CEO Sharizad Jumaat tells ***FocusM*** that EPF's investment is driven by its own strategic asset allocation which may be different from other institutions.

"EPF's allocation structure ensures that investment portfolios are managed in a prudent manner and are not so susceptible to any harsh market movements," she says.

Sharizad feels it is more important to recognise that EPF has generated a positive real rate of returns exceeding its two key investment objectives. This, she says, will protect, safeguard and add value to its members' savings in the long run.

The research manager reiterates that EPF recorded a higher gross investment income of RM46.5 bil last year, compared to 2015's RM44 bil, while EPF emphasised that last year's income is the highest ever recorded since it was established in 1951.

That said, she asked if it wasn't expected of EPF to have continuous income growth.

"With contributions growing over the years, surely [EPF] members can't be so tolerant and expect the retirement fund to post the same income every year.

"EPF members' accumulated contributions grew from a modest RM4 bil in 1975 to about RM700 bil to date," she says.

Even then, despite increasing income and contributions since 1951, the dividend payout has stagnated around the RM37 bil to RM38 bil range in the past three years.

Ambrose says a dividend rate of 5.7% in the harsh environment of last year's capital markets "is commendable".

"Bear in mind that global interest rates remain just above the lowest they have ever been, and that large funds have been scouring the earth for decent returns all year," he says.

Ambrose says if one were to combine that with the new accounting rules on impairment and the imperative that the national pension fund must be extremely prudent with its investments, it is considered as having another year of strong performance without endangering Malaysian employees' savings.

He says EPF's assets soared to RM731 bil which means it is that much harder to achieve returns in terms of percentage.

"For example, EPF had to realise net gains of RM6.5 bil for every one percent of returns versus only RM5.4 bil in 2014 – just two years ago," Ambrose says.

Sharizad says: "We should view impairment of equity investment in a positive manner.

"It is a prudent way to manage the mark to market value of an equity portfolio arising from the much higher volatility within a difficult environment."

She too emphasised that impairment is aligned to the MFRS 139 accounting policy. If we look at the impairment size, it is only 2.6% of the entire equity portfolio, Sharizad says.

The research manager notes that impairment, at just over 1% (of last year's) total assets, is considered low.

"But [2015] impairment works out to only 0.4% of total assets of RM684 bil [as at end of 2015]. It would have been more prudent to ensure that ratio is kept low at around the 0.5% level [last year]."

Some 73% of the impairment came from the domestic market, of which 49% involved banking sector assets.

The impairment for this sector works out to RM2.9 bil while another RM1.5 bil was related to the oil and gas sector.

Banking investments

As at the end of 2015, of EPF's top 10 equity holdings by percentage of issued shares, six were in the banking sector.

Topping the list was Malaysia Building Society Bhd (MBSB) which has since increased marginally to 65.28% as at February. EPF's stake in MBSB is worth approximately RM4.3 bil.

The top three have remained unchanged since 2014. As for the other banking stocks in 2015's top 10 list, EPF has since reduced its stake in the banks concerned by an average of 2.5% as at February.

Reanda LLKG International Chartered Accountants managing partner Koong Lin Loong tells ***FocusM*** that impairment can be reversed.

He says when the value of assets has been impaired and the company later sells it, the proceeds will be accounted to the gain or loss on disposal of assets account.

Are EPF members set for a bumper year in 12 months' time then?

The research manager foresees the possibility of the impairment being reversed, more commonly referred to as write backs.

However, she believes EPF has never done write backs previously. EPF did not respond to ***FocusM***'s queries with regard to this.

Sharizad is optimistic of write backs in the near term. "Most investment houses are of the view that the equity market this year may perform around 4% as compared to -3% and -5% last year and in 2015 respectively.

"Based on that positive scenario, EPF is expected to have write backs this year," she says. FocusM

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Shahril Ridza and his team are under pressure to deliver better returns this year

List of EPF's top 10 equity holdings by percentage of issued shares as at end 2014 & 2015

	2014		2015
Malaysia Building Society Bhd	64.2%	Malaysia Building Society Bhd	65.1%
RHB Capital Bhd	41.5%	RHB Capital Bhd	42.2%
Malaysian Resources Corporation Bhd	38.9%	Malaysian Resources Corporation Bhd	38.4%
Shell Refining Co (FoM) Bhd	16.6%	Malakoff Corporation Bhd	18.8%
Media Prima Bhd	15.8%	UMW Holdings Bhd	17.8%
Genting Plantations Bhd	15.5%	Alliance Financial Group Bhd	17.7%
Alliance Financial Group Bhd	15.3%	Tenaga Nasional Bhd	17.4%
UMW Holdings Bhd	15.2%	CIMB Group Holdings Bhd	17.4%
Telekom Malaysia Bhd	14.7%	Malayan Banking Bhd	17.1%
Public Bank Bhd	14.7%	AMMB Holdings Bhd	16.5%

Source: **EPF**