

Pension Fund Industry Reform: A Necessity

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Market Overview

Pension funds are vital to the national economy, providing financial security for retirees and driving economic growth through channeling investment into infrastructure development and corporate financing. Pension funds also enhance social welfare and economic resilience by promoting financial stability, reducing government dependency, and encouraging savings. Furthermore, aligning pension funds with sustainable development objectives promotes environmentally conscious and inclusive growth. To address the challenges of an aging population and promote sustainable economic growth, it is imperative for developing countries such as Indonesia to fortify the pension fund sector.

The Indonesian pension system received an aggregate score of 51.8 in the 2023 Mercer CFA Institute Global Pension Index (MCGPI), which assesses retirement income systems worldwide, an improvement score from 49.2 in 2022. Indonesia is among the lowest-performing systems worldwide, with South Korea (scored 51.2) and Austria (scored 52.5), as indicated by this score, corresponding to a 'C' grade. The evaluation recognizes Indonesia's relatively robust framework regarding the pension system; however, it also emphasizes critical issues regarding the provision of sufficient benefits and the maintenance of long-term sustainability.

In Indonesia, pension funds are divided into two categories: mandatory and voluntary. The government has established mandatory pension funds for basic insurance and pension programs. These funds are managed by institutions such as BPJS Ketenagakerjaan (serving formal sector employees), PT TASPEN (Persero) (serving civil servants), and PT Asabri (Persero) (serving members of the Indonesian Armed Forces and Police). TASPEN and Asabri are social life insurance providers providing life insurance and pension programs, and Pension Program (Program Pensiun) and Old-Age Savings Program (Tabungan Hari Tua) are mandatory programs under the management of these institutions.

Furthermore, voluntary pension funds in Indonesia, regulated by the Financial Services Authority (Otoritas Jasa Keuangan, OJK), are classified into three types:

1. Employer Pension Fund – Defined Benefit Plan (EPF-DB): Established by employers for their employees, this fund operates on a Defined Benefit (DB) plan, where pension benefits are predetermined based on factors such as salary and years of service.
2. Employer Pension Fund – Defined Contribution Plan (EPF-DC): Similar to EPF-DB but based on a Defined Contribution (DC) plan. In this model, the benefits are determined by contributions and investment returns earned over time.
3. Financial Institution Pension Fund (FIPF): Established by financial institutions, such as banks or insurance companies, this type of pension fund caters to individuals and groups, including self-employed individuals. FIPFs are designed to be accessible and flexible for a broader spectrum of participants, as they operate under a Defined Contribution plan.

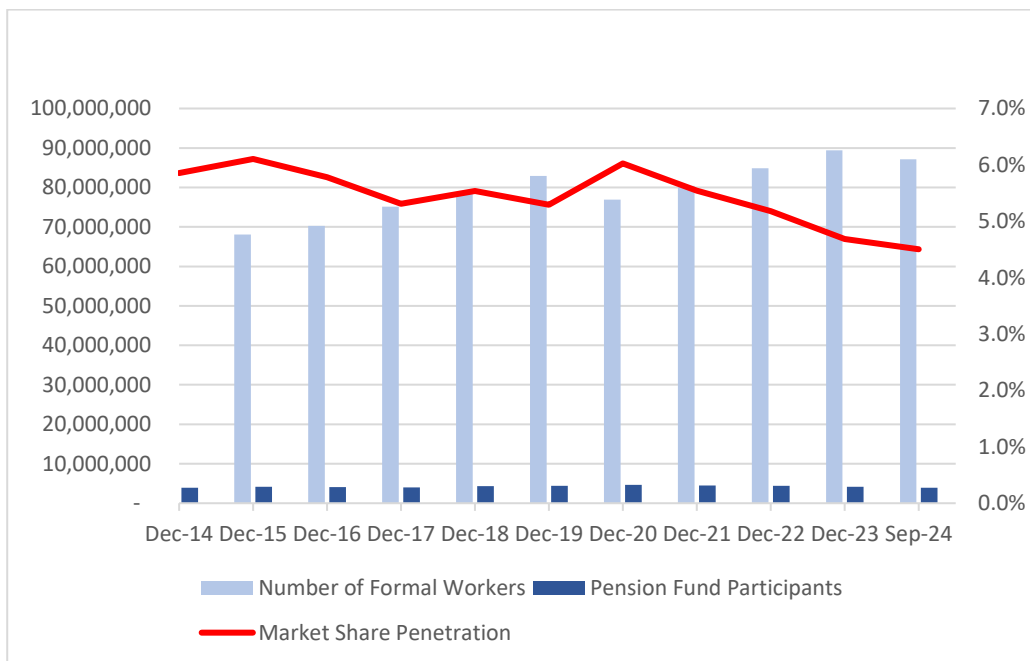
This article will provide an in-depth analysis of the voluntary pension funds landscape. Voluntary pension funds complement government programs by enhancing financial resilience and stability. Below are the key trends that have shaped the development of voluntary pension funds over the past decades.

Low Penetration Rate

Indonesia's voluntary pension fund industry has faced substantial obstacles, predominantly due to low market penetration amid the population's limited financial literacy. The financial literacy index for pension funds was 14.13%, as indicated by the 2019 National Survey on Financial Literacy and Inclusion, while the financial inclusion index was only 6.18%. These statistics suggest that only a small percentage of Indonesians are aware of and actively engaged in pension fund programs, underscoring the pressing necessity for targeted educational initiatives to address the gap.

The penetration of voluntary pension funds remains low, with only 4.5% of the national workforce participating in pension programs as of the third quarter of 2024, as illustrated in Graph 1 below. This limited growth in pension fund participation is primarily due to the dominance of the informal employment sector, comprising approximately 65% of the total workforce. Since pension funds mainly target formal sector employees, a significant portion of the labor force remains outside the scope of these programs.

Graph 1. Penetration of Voluntary Pension Funds



Source: OJK, processed by PEFINDO

To improve financial literacy regarding the importance of pension funds and increase the number of participants, digital solutions present a significant opportunity for advancement. These solutions can streamline enrollment processes, improve communication, and foster greater engagement in pension fund programs. Collaborating with fintech startups offers a promising pathway for innovation within Indonesia's pension fund sector. Such partnerships can drive the development of sophisticated solutions, including automated contribution systems, and mobile-enabled retirement planning platforms.

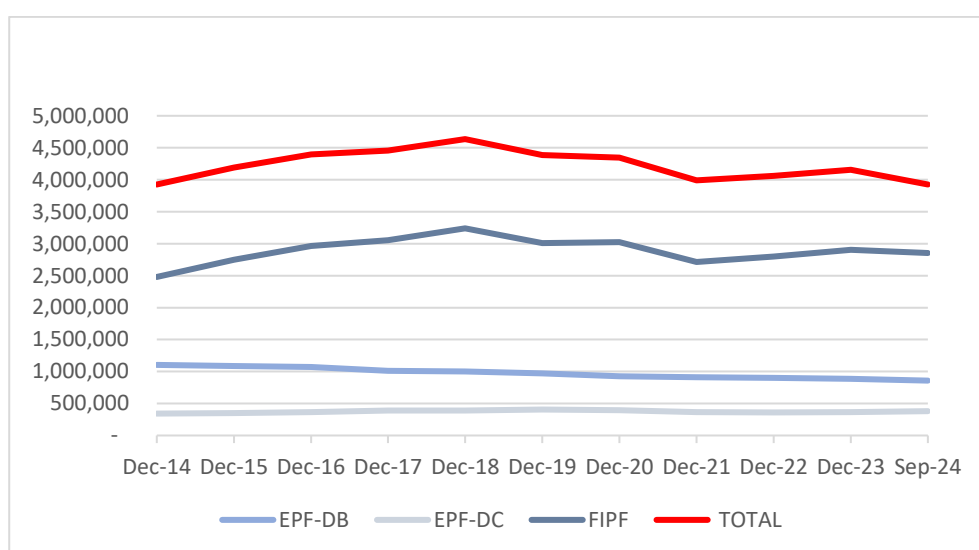
Fluctuating Number of Participants

The number of pension fund participants in Indonesia has fluctuated over the past decade, as illustrated in Graph 2 below. Participation stood at 3,925,444 at the end of December 2014 (FY2014), peaked at 4,635,074 in FY2018, and declined to 4,092,110 by 9M2024. The sharp increase in FY2018 can

be attributed to significant improvements in data collection and reporting by pension providers, which brought previously underreported participants into the official figures.

PEFINDO also noted a notable decline in pension fund participants from 4,345,738 in FY2020 to 3,990,234 in FY2021, largely driven by the economic uncertainties caused by the COVID-19 pandemic, which led to widespread job losses and reduced incomes. As a result, many individuals withdrew from pension schemes to address immediate financial needs, further impacting overall participation rates. On top of this, the increasing cost of living also contributed to this decline, exacerbated by the ongoing transition from DB to DC plans, which are considered less alluring because the shift places investment risks on employees.

Graph 2. Number of Pension Fund Participants



Source: OJK, processed by PEFINDO

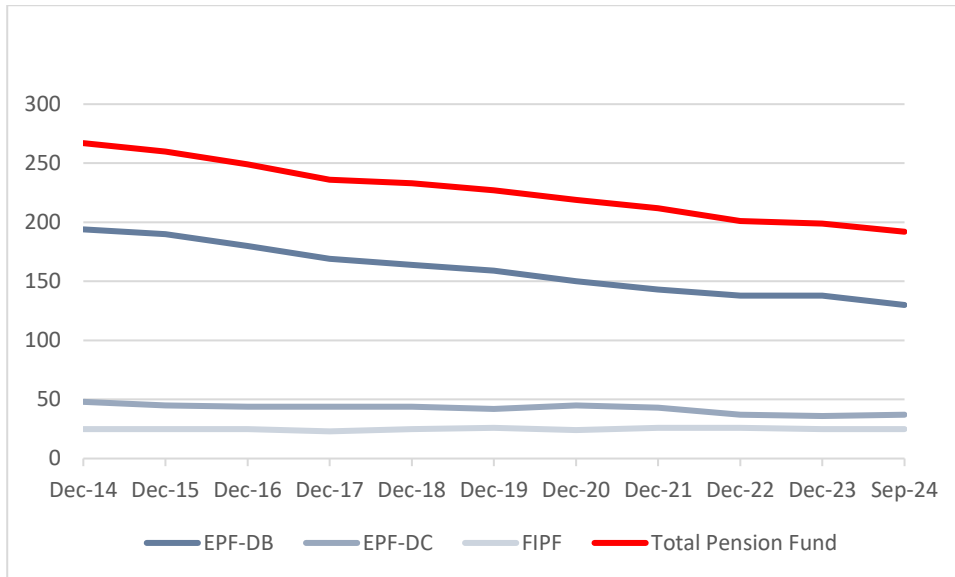
Switching Trends from Defined Benefit Plan to Defined Contribution Plan

Over the past decade, many companies in Indonesia have increasingly transitioned away from DB plans due to the high and unpredictable costs associated with funding lifetime benefits. DB plans require substantial financial commitments from employers, which are further strained by factors such as increased life expectancy, lower investment returns, and heightened regulatory requirements. On the other hand, employers increasingly opt to move away from DB plans due to the substantial costs and long-term liabilities they entail.

As a result, many DB plans have been replaced or supplemented by DC plans, where employees assume the investment risks, offering greater predictability for employers. DC plans transfer investment risk to employees, which can diminish their attractiveness as individuals bear the uncertainties of market fluctuations. While transitioning to DC plans offers significant cost savings for employers, they remain responsible for managing contributions on behalf of employees. This underscores the critical importance of robust oversight and prudent risk management in administering DC plans. Failure to achieve satisfactory investment performance could exacerbate government social risks, particularly in the context of Indonesia's tightening demographic profile and increasing pressure on social welfare systems. Effective governance and regulatory frameworks will be essential to mitigate these risks and ensure long-term sustainability.

The switching trend from DB plan to DC plan has decreased pension fund providers, as illustrated in Graph 3. The total number of pension fund entities decreased from 267 on FY2014 to 192 on 9M2024. The primary cause of this decline is the decrease in the number of Employer Pension Funds operating under the Defined Benefit Plan (EPF-DB), primarily driven by the unsustainable financial burdens they impose on employers, combined with regulatory tightening as requested by OJK and economic pressures. In contrast, the number of other categories of pension funds has remained relatively stable.

Graph 3. Number of Pension Funds



Source: OJK, processed by PEFINDO

As of 9M2024, despite a decline in the number of providers, the pension fund industry remains predominantly comprised of Employer Pension Funds with Defined Benefit Plans (EPF-DB), representing approximately 67.7% of total pension funds. This is followed by Employer Pension Funds with Defined Contribution Plans (EPF-DC) at 19.3% and Financial Institution Pension Funds (FIPF) at 13.0%. PEFINDO anticipates that the number of pension funds operating under the DB plan will continue to decrease in the near to medium term as many providers transition to the DC plan.

Lack of Transparency

The pension fund industry also faces significant governance challenges, highlighted by several high-profile fraud cases that have eroded public trust. These issues often arise from a lack of transparency, which impedes the early detection of irregularities. While regulatory frameworks exist, inconsistent enforcement allows dishonest individuals to exploit loopholes and engage in fraudulent activities. Many fraud cases involve poor investment management, characterized by risky allocations to speculative assets that promise high returns but lack proper due diligence. In addition, collusion and kickbacks in dealings with external parties, such as investment advisors or brokers, have further worsened governance issues.

Despite the substantial obstacles, the pension fund industry in Indonesia is well-positioned to capitalize on substantial opportunities driven by regulatory reforms and innovation. The Financial Services Authority (OJK) has proposed a comprehensive "Roadmap for the Development and Strengthening of Indonesian Pension Funds 2024–2028," which is based on Law No. 4 of 2023 on Financial Sector Development and Strengthening. This roadmap prioritizes digital transformation to enhance

accessibility, operational efficiency, and service delivery while emphasizing the harmonization of the pension system across mandatory and voluntary funds.

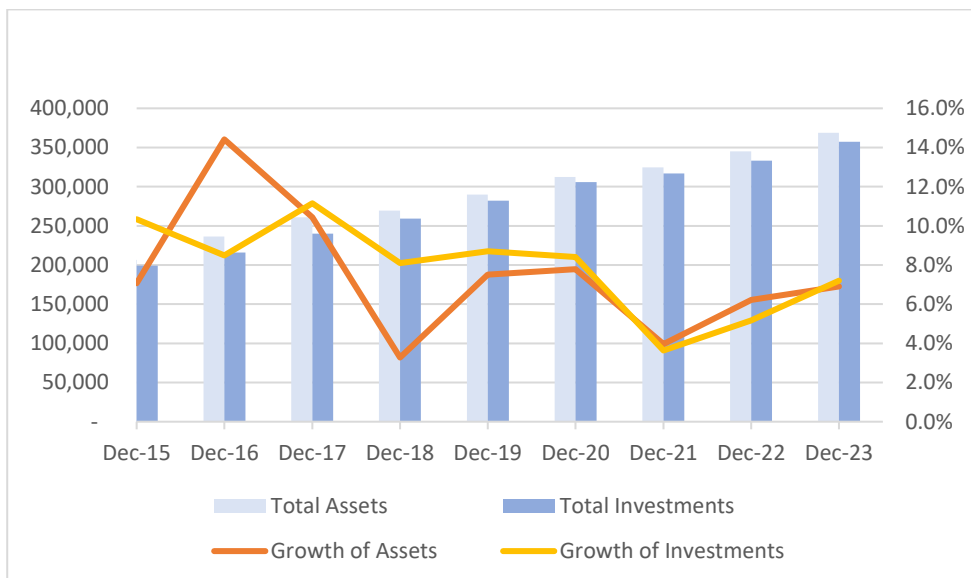
The roadmap is divided into multiple segments, beginning with initiatives to enhance governance practices, increase public awareness, and develop human resources. The primary objectives of the subsequent phases are the consolidation of voluntary pension programs and the advancement of digitalized services and business processes. The final phase entails the assessment of progress and the more comprehensive integration of pension funds into Indonesia's financial services sector to align with long-term national financial objectives.

Regulatory reforms are intended to improve the transparency and accountability of the pension fund sector. Prudent management of pension assets requires the implementation of robust internal controls, transparent reporting mechanisms, and risk management. Additionally, these measures are intended to improve trust among participants and increase the availability of pension funds for both formal and informal workers. The industry's sustainability and inclusivity can be enhanced by a transparent and trustworthy system that unlocks participation from previously unreached segments.

Improved Financial Indicators

Despite facing some challenges during the past decades, pension fund assets have shown consistent growth, averaging 7.1% annually over the past decade. As of 9M2024, pension fund assets have reached IDR380,805 trillion, up from IDR192,900 trillion in FY2014. This growth is supported by the expansion of investments, which have grown at an average rate of 7.4% annually, increasing from IDR180,375 trillion in FY2014 to IDR368,553 trillion in 9M2024, as depicted in Graph 4 below.

Graph 4. Total Assets and Total Investments

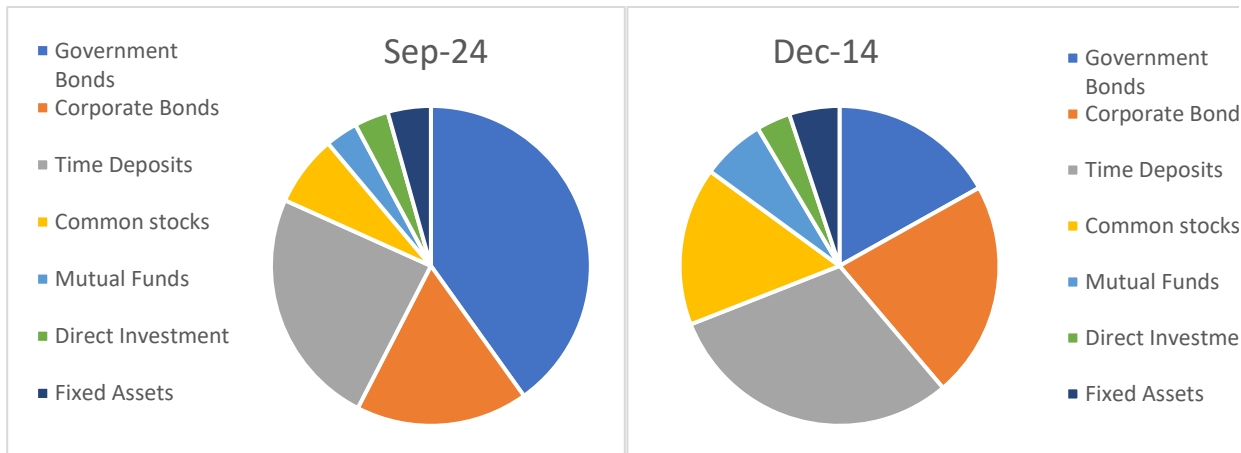


Source: OJK, processed by PEFINDO

Over the past decade, pension funds have undergone notable shifts in their investment portfolios, reflecting evolving market dynamics and strategic priorities. A significant trend is the growing preference for government bonds, driven by their stability and attractive yields, as presented in diagram 1. As of 9M2024, government bonds accounted for 40% of total pension fund portfolios, a substantial increase from 16.9% in FY2014. Conversely, the allocation to common stocks has declined markedly, representing only 7.2% of the total portfolio in 9M2024, down from 16.0% in FY2014. These

adjustments indicate a strategic shift towards lower-risk, income-generating assets to ensure portfolio resilience and long-term sustainability.

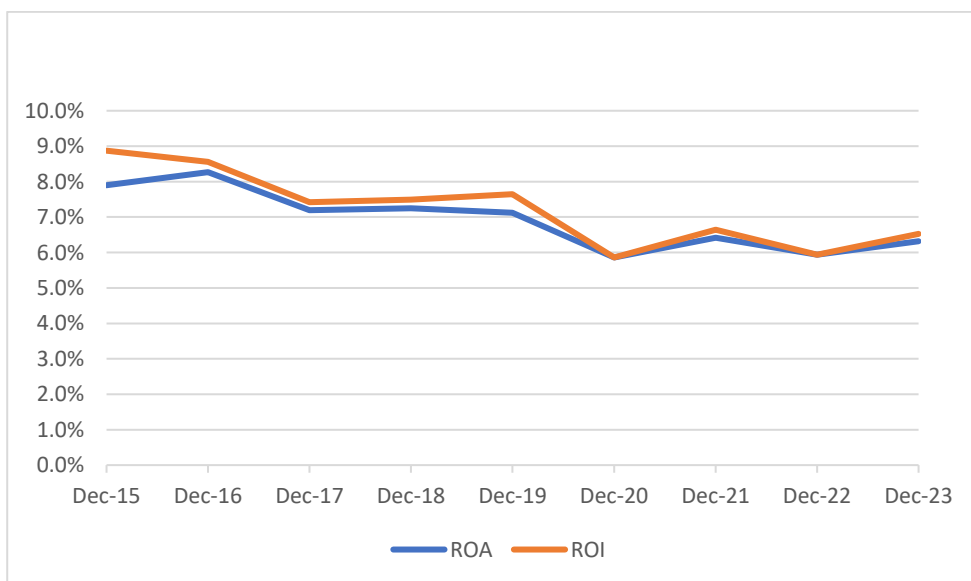
Diagram 1. Pension Funds Investment Portfolio



Source: OJK, processed by PEFINDO

This investment growth aligns with trends in the return on assets (ROA) and return on investments (ROI) for the pension fund industry, as presented in Graph 5. The most significant ROA levels were observed in 2015 and 2016, driven by resilient financial market performance, high interest rates, and favourable economic conditions. Nevertheless, ROA has been in a gradual decline since 2017 due to factors such as increased market volatility, weaker equity market performance, and reduced interest rates. In 2015, the average ROI for pension funds reached its highest point of 8.9%. However, this figure has since declined to 6.5% in December 2023. The recent data indicates that all pension fund categories have reported their lowest ROI levels in the past decade. This raises concerns about the sustainability of returns under current economic conditions and signals the necessity of strategic adjustments in investment processes.

Graph 5. ROA and ROI



Source: OJK, processed by PEFINDO

Regulatory reforms also create opportunities for more diversified investment strategies. Enhanced oversight and industry consolidation are expected to position pension funds to allocate assets more effectively, including alternative investments offering higher returns with manageable risks. As major institutional investors, pension funds can be pivotal in promoting sustainable investments. By integrating ESG (Environmental, Social, and Governance) criteria into its strategies, pension funds align with global trends and appeal to socially conscious investors. This approach not only fosters fund growth but also contributes to broader economic and environmental sustainability goals.

Conclusion

Pension fund industry reform is a necessity for Indonesia, driven by the country's ongoing demographic shift toward an aging population. The current period, where the number of productive workers still significantly exceeds retirees, presents a strategic window for increasing pension fund penetration before the aging demographic takes full impact. However, the reform process must be transparent and consistently monitored to maintain public trust. One way is to use the assessment from independent party as a valuable tool for pension funds to evaluate their progress over the years under review and demonstrate their commitment to transparency and accountability to participants.

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