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Opportunities and Challenges in Developing Islamic Pension Funds in Indonesia

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Abstract. *Despite the rapid development of the Islamic financial sector in Indonesia, the development of Islamic pension funds is way behind those of the other Islamic financial sectors. This study aims to explore the opportunities and challenges faced by Indonesian Islamic pension funds. Utilizing a qualitative research method, the study conducted Focus Group Discussions with 23 large pension funds spread across five big cities in Indonesia. It was revealed that opportunities and prospects for developing Islamic pension funds in Indonesia are relatively good. However, various internal and external challenges were found, such as a lack of knowledge; the weak commitment of founders; lack of quality human resources; relatively unfavorable tax treatment; limited investment instruments; competition with government pension schemes; and public literacy problems. Therefore, two broad strategies are recommended to develop the Islamic funds, namely the provision of direct/indirect incentives to market players, and literacy programmes to targeted/priority groups. These strategies are expected to encourage and accelerate the growth of Indonesia's Islamic pension fund industry in the future.*

Keywords: *Islamic pension fund, pension fund, Islamic non-banking institution, Islamic finance.*
JEL Classification: H55, H75, J32

Abstrak. *Meskipun sektor keuangan syariah berkembang pesat di Indonesia, perkembangan dana pensiun syariah tertinggal jauh dari sektor keuangan syariah lainnya. Penelitian ini bertujuan untuk mengeksplorasi peluang dan tantangan yang dihadapi oleh dana pensiun syariah Indonesia. Dengan menggunakan metode penelitian kualitatif, studi ini melakukan Focus Group Discussion dengan 23 dana pensiun besar yang tersebar di lima kota besar di Indonesia. Terungkap bahwa peluang dan prospek pengembangan dana pensiun syariah di Indonesia relatif baik. Namun ditemukan berbagai tantangan internal dan eksternal, seperti kurangnya pengetahuan; lemahnya komitmen para pendiri; kurangnya sumber daya manusia yang berkualitas; perlakuan pajak yang relatif tidak menguntungkan; instrumen investasi terbatas; persaingan dengan skema pensiun pemerintah; dan masalah literasi publik. Oleh karena itu, disarankan dua strategi luas untuk mengembangkan dana syariah, yaitu pemberian insentif langsung/tidak langsung kepada pelaku pasar, dan program literasi kepada kelompok sasaran/prioritas. Strategi-strategi tersebut diharapkan dapat mendorong dan mempercepat pertumbuhan industri dana pensiun syariah Indonesia di masa depan.*

Kata Kunci: *dana pensiun syariah, dana pensiun, lembaga keuangan syariah non bank, keuangan syariah*

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Introduction

Pension funds are financial institutions that run retirement benefit schemes. As financial and investment funds, they provide benefits to individual participants, such as enabling them to have a steady income when they retire (Scott, 1988). They also act as investment instruments that can provide returns in the future (Blake, 2006; Sullivan et al., 2020). Indeed, related to the investment function of pension funds, more recently they have also been considered to be a reflection of the political leaning of their beneficiaries, aiming to gain more benefits from them (Hoepner & Schopohl, 2019; Anzia & Moe, 2019).

From a macroeconomic perspective, the existence of a well-developed pension fund industry is expected to increase economic growth, maintain financial system stability and complement the banking system in channeling funds to the real sector. The role of pension funds in promoting economic growth is made possible as the industry can channel the pension contributions to long-term investments, both in financial assets and real assets, which will improve the value of the national economy (Mayer et al., 2005). In addition, the existence of national pension fund institutions is considered essential for serving the growing number of aging populations. The absence of a national security scheme will impose a huge burden at the personal and country level unless there is a proper pension scheme (Panetta, 2006).

In Indonesia, pension fund institutions are regulated under Law No. 11/1992 concerning Pension Funds (OJK, 2019). Under this law, the institutions are treated as legal entities that manage and run schemes that promise retirement benefits, while pension benefits are defined as periodic payments paid to participants in the manner specified in existing pension fund rules In addition, several other technical rules govern the operation of pension funds in Indonesia.[1] However, it is notable that until early 2016 there were no laws or regulations governing the implementation of Islamic pension funds in the country.

As there is demand for Islamic pension funds in Indonesia, the National Sharia Council of the Indonesian Ulama Council (DSN-MUI) has issued several decisions (fatwas) related to the implementation of Islamic pension schemes. These rules include Fatwa No. 88/DSN-MUI/XI/2013 concerning General Guidelines for the Implementation of Pension Programs Based on Sharia Principles and Fatwa No. 99/DSN-MUI/XII/2015 related to sharia annuities (*al-Ratib al-Taqa'udi al-Islami*) (Rahmadini, 2019; Salam & Irsyad, 2020).

The DSN Fatwa No.88/2013 explains various matters related to the contracts used between pension plan holders and pension fund institutions; pension funds with investment managers; and pension funds with third parties who channel funds under the management of pension fund investments (see Figure 1). Meanwhile, Fatwa No. 99/2015 explains about the contract or the relationship between parties in the sharia pension fund, as illustrated in

[1] The regulations include, among others, Government Regulation No. 76/1992 on Employers' Pension Funds; Government Regulation No 77/1992 on Pension Funds of Financial Institutions; PMK no 91/PMK.05/2005 regarding the second amendment to the Decree of the Minister of Finance No. 343/KMK.017/1998 on Pension Benefits; PMK No. 19/2012 on Pension Fund Investment ; PMK No. 50/2012 on the third amendment to Minister of Finance Decree No. 343/KMK.017/1998 on Pension Fees and Benefits ; and PMK No. 234/PMK.03/2009 regarding tax incentives for Pension Funds.

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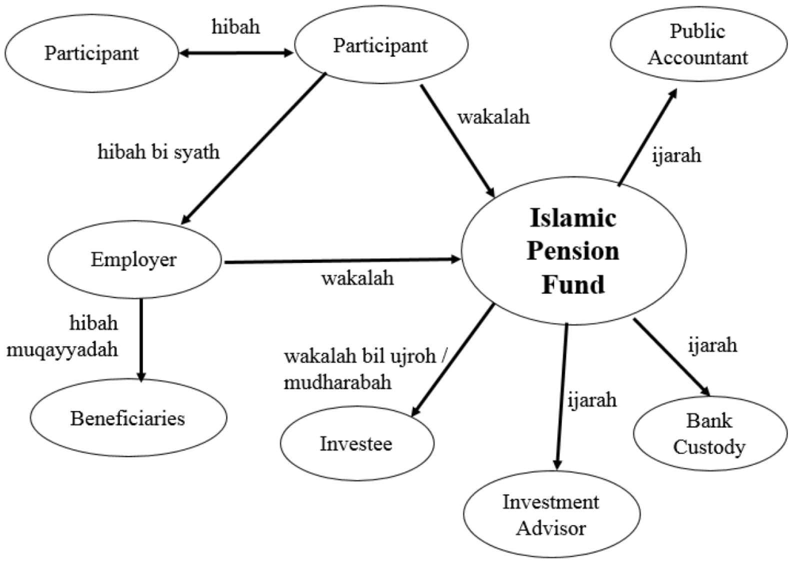
Figure 1. In was in 2016 that the Indonesia Financial Services Authority (OJK) officially issued Regulation Number 33/POJK.05/2016 concerning the Implementation of Pension Programs Based on Sharia Principles (OJK, 2016).

Figure 1. Islamic Pension Fund Schemes in Indonesia



Source: Authors' illustration based on Fatwa No. 88/DSN-MUI/XI/2013

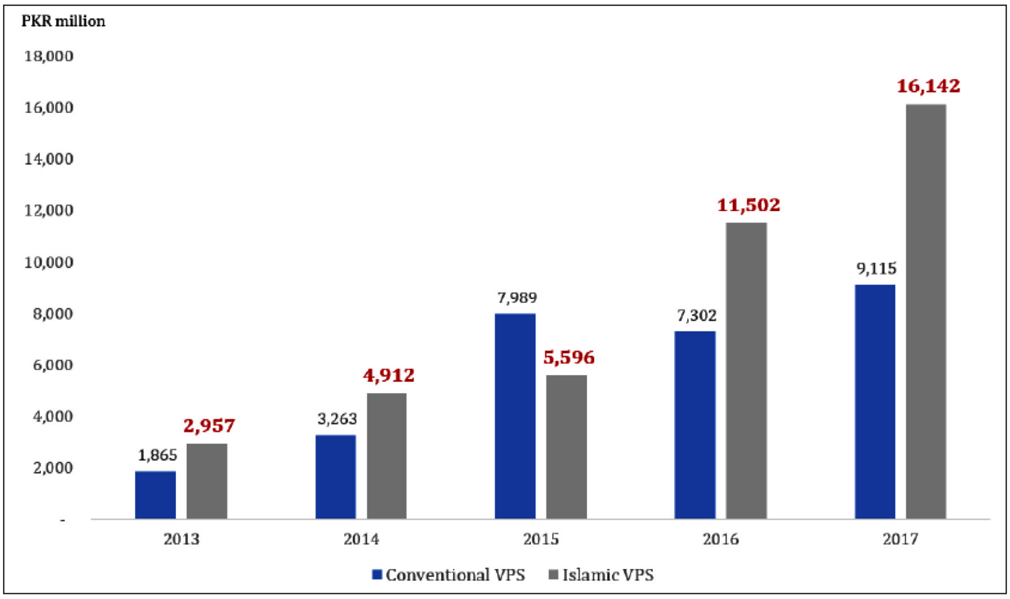
Despite the development of the regulatory framework, in the past five years the growth of the pension fund industry has tended to decline. In 2014, the number of workers participating in pension funds accounted for 5.85% of the total workforce while the number of pension funds players accounted to 267 funds (OJK, 2015b). However, from 2014 to 2018 the number of funds fell by 35, although net assets continue to grow until slowing down in 2018. The average growth of pension fund net assets from 2014 to 2018 was 10.67% per year, but this growth began to slow down from 2017 to 2018, to only 2.76% (OJK, 2018).

With respect to Islamic pension funds, there were only two players in the market by December 2018, with a total of 128,021 participants and assets of 1542.89 billion rupiahs. Compared to the countrywide total pension fund assets of 268.03 trillion rupiahs, the market share of Islamic pension funds was only around 0.5% (OJK, 2018). Despite that, an earlier survey conducted by the OJK suggested that the pension fund industry in Indonesia still had great potential for development. Indeed, the survey also found that about 80% of Indonesians were in fact interested in investing their money in Islamic pension funds (OJK, 2015a).

This optimism is presumably related to the growth of Islamic pension funds in other Muslim countries, such as Pakistan and Malaysia. In Pakistan, the rapid development of such funds is strongly related to the fiscal and financial reforms conducted by the government. The policies that have positively influenced the development of the funds include the introduction of Voluntary Pension Scheme (VPS) in 2005, which allowed individuals to voluntarily contribute to a pension fund (either Islamic or conventional) during their working life; favorable tax regulations (i.e. income tax exemption against retirement benefit);

the availability of investment instruments for Islamic pension funds (such as in the form of sovereign *sukuk ijarah*); and the launch of the Sharia Capital Market Map 2015, which issues regulations on various Islamic financial products, including sharia pension funds (Afzal, 2014). These favorable conditions allowed Islamic pension funds in Pakistan to perform better than the conventional counterparts. By 2017, the total assets of Islamic pension funds in Pakistan accounted for 16,412 million PKR (Figure 2). This indicates that the market share of Islamic funds is 64%, well above that of conventional funds (COMCEC, 2018).

Figure 2. Total Assets of Conventional and Islamic Pension Funds in Pakistan



Source: COMCEC (2018)

Positive developments have also been documented in Malaysia, where Islamic pension schemes have been gradually introduced since 2012, along with the introduction of market liberalization policies. Various pension reforms were also made, including the introduction of the Private Retirement Scheme (PRS), a private pension scheme offering 30 pension fund products, six of which are Islamic-based investment options. In April 2014, the Prime Minister of Malaysia announced investment in the Islamic EPF (Employee Provident Fund) of USD 160 trillion (Arafa, 2014). As of 31 December 2017, the sharia assets stood at 47.5 per cent of the fund's total asset exposure and contributed 42.9 per cent of total income in 2017.[2]

Considering the very small market share of Islamic pension funds in Indonesia, the relatively high demand and large market potential for the funds in the country, as well as the positive development of such funds in other Muslim countries, it is appropriate to evaluate the development of Islamic pension funds in Indonesia. In particular, it is extremely important to explore the challenges faced by the industry so that its development does not lag behind that of conventional funds in Indonesia and of similar funds in other Muslim countries.

[2] https://thelawreviews.co.uk/edition/the-islamic-finance-and-markets-review-edition-4/1209537/malaysia. Accessed 28 June 2020.

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A number of studies have addressed the challenges and opportunities for Islamic pension funds across various countries. For example, Manjoo (2012b) highlighted the opportunity for Islamic pension fund development in the UK, while Icke & Akbaba (2015) assessed the performance of Halal pension funds in Turkey. A study by Nayan & Othman (2019) also discussed the role of the Employee Provident Fund (EPF) as a Sharia-compliant fund pioneer embarking on a new journey for Islamic retirement planning in Malaysia.

Meanwhile, despite the huge market potential for the development of Islamic pension funds in Indonesia, studies on such funds are rare. Aziz et al. (2019) attempted to find the variables that affected the assets of pension funds owned by an Islamic financial institution in Indonesia. In addition, Karina et al. (2020) explored Islamic pension fund potential from the demand side, discussing the attitudes and expectations of Indonesian Muslims towards such funds.

However, it appears that almost no comprehensive and systematic empirical studies have attempted to investigate the issues of Islamic pension fund development in Indonesia. From this perspective, this qualitative study aims to explore the opportunities and challenges in developing such funds. Primary data were collected through focus group discussions (FGDs) and interviews with management personnel of 23 pension funds spread across five large cities in Indonesia (Jakarta, Bandung, Surabaya, Medan and Makassar). The data were subsequently analyzed thematically and in terms of content. It is hoped that the results will provide insights for policy makers and industry players to accelerate the development of the Islamic pension fund industry in the world's largest Muslim country.

Methods

In line with the research objectives explained above, this study employs a qualitative research approach to exploring the prospects and challenges of the Islamic pension fund industry in Indonesia. Qualitative research generally aims to explore new issues or seek new perspectives on specific issues. This can address by collecting primary data from relevant sources and analyzing them with appropriate methods (Bryman, 2008). In contrast, quantitative research is used in response to relational questions concerning variables within the research (Leedy & Ormrod, 2001). Therefore, the qualitative research approach is considered to be the most suitable method to answer the research questions and establish the prospects and challenges of the Islamic pension fund industry in Indonesia

To obtain the primary data, six series of Focus Group Discussion (FGDs) were conducted in five metropolitan cities in Indonesia, namely Jakarta, Bandung, Surabaya, Medan and Makassar. The sample comprised 23 pension fund institutions registered with the OJK. The institutions were carefully selected from funds with large assets representing three regions in Indonesia, i.e. Java (19 funds operating in Jakarta, Bandung and Surabaya), Sumatra (two funds operating in Medan), and Sulawesi (two funds operating in Makassar). Therefore, the samples were considered to be a good representation of the pension fund industry in Indonesia, and were expected to provide good quality data and insights to help achieve the research objectives. Furthermore, during the FGDs, the questions addressed focused on the opportunities and challenges faced by the industry players. Recommendations from them, if any, werere also noted.

After the qualitative data were obtained, the findings were examined using thematic analysis and content analysis. Despite the various methods available in qualitative data analysis, thematic analysis is mostly used whenever it is necessary to summarize, interpret and compare the key features (themes) from a large qualitative dataset (Braun & Clarke, 2006). This method has been used in many organizational and industrial studies (Bryman & Burgess, 2002; Cassell & Symon, 2004; Miller et al., 2004), including ones on finance institutions (Kaczynski et al., 2014). The other method utilized was content analysis, which is useful in interpreting documents and communication materials so that values, intentions and attitudes can be analyzed (Duriau et al., 2007; Loughran, & McDonald, 2016; Mohajan, 2018). Because of their suitability for answering the research questions, data analytical tools were employed in the study.

Results and Discussion

Current Situation and Opportunities

At first, the current situation was investigated in terms of knowledge levels regarding Islamic pension funds. From the FGD findings, it was revealed that the current state of the Islamic pension fund industry in Indonesia is affected by a lack of awareness and understanding regarding the concept and implementation of such funds. This was found not only amongst the Indonesia public, as suggested by a survey conducted by the OJK (OJK, 2015a), but also amongst the founders and managers of pension funds. This view was expressed by most of the respondents. Furthermore, it was found that the knowledge level of pension fund managers regarding Islamic funds was strongly influenced by information and education related to such funds.

Several respondents emphasized the importance of knowledge and education. One from North Sumatra, for example, expressed his lack of understanding of the concept of Islamic pension funds because he had never participated in education related to them. He mentioned that *"I myself have never heard of this Islamic pension fund... We have no clue. We are still blind about that Islamic pension fund...We are very blank about Islamic pension funds."* Furthermore, it was revealed that knowledge about Islamic pension funds came from involvement with pension fund associations. One respondent mentioned that she knew about several aspects of Islamic funds because she involved with the Association of Pension Funds in Indonesia (ADPI), while another respondent mentioned that he found out about Islamic funds from his workplace, which coincidently was a local Islamic university, but never involved in Islamic pension funds.

Despite this lack of knowledge, the majority of the respondents gave positive responses regarding the future prospects of Islamic pension funds in Indonesia, as well as in other countries. Habib (2009) conducted a survey on this topic and found Islamic pension funds to be an expanding market and an obvious area for investment. Kasri et al. (2017) explored the demand for Islamic pension funds in Indonesia and found that more than 70% of their

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respondents were interested in having an Islamic pension plan. This finding is supported by the fact that a large number of Indonesians are Muslim, and most of them do not have pension plans yet because current (conventional) pension funds are forbidden as they involve usury/riba practices (Manjoo, 2012a). This was emphasised by one of the pension fund managers, who stated "*For the conventional pensions alone, there are still people who think that [conventional] pensions are forbidden. I took part in a seminar a few times, and they openly said that they are forbidden*". Therefore, when Islamic funds are developed and more players exist, it is predicted their development will be massive. Indeed, it was mentioned by one of the respondents that *"Insha Allah, the future growth of [Islamic] pension funds is still very big."*

Internal and External Challenges

The development of Islamic pension funds in Indonesia is highly likely to be affected by various internal and external barriers. On the internal side, factors concerning the founder, human resource management and accounting systems appear to be the main issues and challenges in developing the Islamic pension funds.

The importance of the pension fund's founder, who has the authority to set targets and make direct fund investments, was strongly felt by the fund managers. This was reflected by one respondent, who believed that *"[The most thing important is] the founder's understanding. So, the mindset of that person [is important]"*. Nelson (2010) states that the firm founder role is essential in delivering new products and services to the marketplace and even creating entirely new categories of industry. Therefore, the initiative and support from founders are crucial in developing Islamic pension funds in Indonesia, as they are the company decision makers. However, as most of the founders have very little knowledge or concern regarding Islamic pension funds, support for converting or establishing such funds is minimal. In the words of one fund manager, the lack of support is *"Because the founders are little concerned about Islamic pension funds"*.

Another similar, yet related, internal barrier that emerged during the FGDs was the lack of human resources (managers, staff etc.) who understand Islamic pension funds. Such understanding should not only include the main aspects of Islamic funds, but also operational and supervisory aspects. Many were also worried about the complexity of the accounting rules that might be implemented should Islamic pension funds be further developed in Indonesia. At the international level, similar concerns also exist. At the IFA 2019 congress, the panelists stated that the tax community was still unprepared for Sharia-compliant finance (Haines, 2019). Nevertheless, each country's rules and guidance are unique in relation to its tax structure. In this study, one of the respondents expressed his hopes for the new industry stating that *"The accounting system should be made as simple as possible. You should develop these Islamic pension funds with simple accounting; easier to apply"*.

On the external side, challenges are related to respect of the role of the OJK (authority), taxes, investment instruments, competition with the government pension plan (such as BPJS), and public literacy. Currently, little guidance and few regulations are in place for Islamic pension funds. Therefore, it is expected that more will be done from the regulatory aspect in the future. Moreover, the taxation rules related to pension funds (such as overpaid corporate tax and double taxation on private pension funds) and the limited Islamic investment instruments in the Indonesia capital market (both in terms of number and type/variation) were perceived to be the main challenges by the pension fund managers. These issues were highlighted by several fund managers.

> *"…when the market is retail, he [the pension fund participant] must have paid income tax. This tax has to be paid again when he wants to get money from the pension funds. So, there is a double tax".*

> *"The other difficulties are [Islamic investment] instruments…there are limited instruments, Sir. So, we know that the instruments, especially in the capital market and money market, associated with sharia instruments are not great in number and not so varied."*

The government's latest policy requiring the participation of Indonesian formal workers in its obligatory pension fund scheme, known as BPJS or 'BPJS *ketenagakerjaan*', was also perceived as an obstacle to the growth of the private pension industry. This will presumably affect the interest of private companies in the establishment of Islamic pension funds in the future. One participant stated:

> *"Maybe for the people who work in SOEs* (BUMN) [the BPJS] is *not too influential. But for the private sector, it is very influential. Because I also work in a private company. There are some companies that ultimately do not participate in pension funds, because there is already BPJS and its nature is mandatory…So, the essence of BPJS itself becomes a threat…"*

Finally, the lack of literacy regarding the concepts and benefits of pension schemes is also perceived as an obstacle to increasing the penetration of pension funds in Indonesia, both conventional and Islamic. This was clearly expressed by several respondents. One fund manager said that, *"It means that…those who do not have pension funds also need to be informed. …the union workers need to be given an understanding of what the pension fund is"*, while another manager emphasized that, *"...next it is important to give people knowledge and understanding. They might not understand what a pension fund is, particularly Islamic pension funds"*. This finding is supported by Karina et al. (2020), who concluded that the low level of knowledge of and trust in Islamic pension funds were the two main reasons for people not taking them out.

Development Strategies

In addition to identifying the opportunities and challenges in developing Islamic pension funds, several respondents suggested a number of recommendations regarding strategies that could be developed to face the challenges. The first strategy emerging from the FDGs was provision of direct and indirect incentives to market players, particularly incentives related to taxes and fees. The second was the development of appropriate literacy programmes to targeted/priority groups, including internal stakeholders, such as the pension fund founder, and groups of people such as religious communities.

From the FGD findings, it was revealed that all the respondents believed that in order for Islamic pension funds to grow and develop properly, it was necessary to incentivize

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conventional pension fund institutions to establish such funds. Several incentives were proposed, including lower taxes, lower fees/contributions to the state/regulator, and more varied Islamic investment instruments (with attractive rates of return).

In relation to taxes and fees, several respondents suggested that corporate tax and government fees should be reduced. This would provide direct incentives, particularly for founders of pension funds, to establish Islamic equivalents. At the same time, the problem of double taxation levied on participants in Islamic pension fund schemes must also be avoided. This double taxation was considered unfair, as participants are taxed at the beginning and the end of the (Islamic) pension fund plan.

> *"There should be a correlation between [the establishment of Islamic pension funds] and corporate tax. Pension payments might have been part of the deduction from corporate tax at the end of the year",* and *"I am back again to incentives … the establishment of a pension fund depends on the founder's willingness. The founder must be given a discount. That would be more interesting, I think."*

> *"In my opinion, the most appropriate incentive is, yes, the contribution [to the state] which is 50% of the conventional fees [levied to conventional pension funds]. [If this is implemented], a lot of people would flock to the sharia pension funds..."*

> *"For example, specifically for individuals, the tax should be removed so that there is no double taxation, because at the beginning, when starting a pension fund, tax is already deducted ... so this should not be the case at the end…We are hit again with taxes, taxation rules, Sir".*

The respondents, who were mostly fund managers, also highlighted the limited types of Islamic investment instruments available in the market. Moreover, some also expressed their expectation that future Islamic financial instruments should produce better returns than their conventional counterparts. Somewhat ironically, this was suggested despite the knowledge that the performance of Islamic instruments depends on market conditions:

> *"Indeed, if we really want to develop sharia funds ... investment instruments should be increased for the type of sharia. Indeed, from experience so far, the returns [of Islamic investment instruments] are still inferior compared to conventional ones".*

> *"Because they [the Islamic instruments] are essentially [based on] profit sharing. The returns are also uncertain. That's what needs to be thought about, so that the returns from the Islamic funds could be good. Because the target of the development of the principal is the level of benefits we can provide to retirees".*

In addition, the respondents emphasized the importance of appropriate literacy programmes to targeted/priority groups, with priority given to the founders of pension funds. This was clearly addressed by one respondent, who stated that *"... most importantly, the authority must arouse the spirit of the founder. So, the key is for the founder, Sir".* Another respondent even suggested that, *"All of us have an obligation to provide an explanation to the founders."*

Other important stakeholders that need to be targeted are communities, such as students (education communities) and *majlis ta'lim* (religious communities). These groups are considered strategic because of their influential roles in society and their concerns for

Islamic issues. According to one respondent, *"The most effective [education campaign] is maybe going to campuses [university students]. [They] can be an extension of [the community]".* Meanwhile, another respondent suggested that, *"[Educational campaigns] to religious communities, yes, they are very effective you know ... Majlis taklim, ladies and gentlemen".*

Conclusion

The study aimed to investigate the prospects and challenges of developing Islamic pension funds in Indonesia, as this sector is considered to have great potential, but is still underdeveloped. Based on the research conducted, several interesting insights can be highlighted. In general, it could be suggested that the current outlook for Islamic pension funds in Indonesia is relatively good. However, various internal and external challenges to their development have also been identified. The main internal challenges include the low level of knowledge amongst the management of pension funds, the weak commitment of fund founders, and the lack of qualified human resources. Meanwhile, the main external challenges include unfavorable tax treatment, limited investment instruments, competition with the government pension scheme, and the low level of public literacy regarding such funds.

Based on the findings and analysis, two strategies for developing the Islamic pension fund sector in Indonesia are recommended. The first is provision of direct/indirect incentives to market players, such as lower taxes and fees. Meanwhile, the second strategy is related to appropriate literacy programmes to targeted/priority groups, including the founder of pension funds and religious communities (external stakeholders). These strategies are expected to encourage and accelerate the growth of Indonesia's Islamic pension fund industry in the future.

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