

ENSURING RETIREMENT ADEQUACY, ALLOWING MORE FLEXIBILITY IN INVESTING FUNDS AMONG CONCERNS

Three areas where CPF could be changed

The Government is reviewing the Central Provident Fund (CPF) system and all eyes will be on the National Day Rally, during which Prime Minister Lee Hsien Loong is expected to, among other things, outline measures to improve the system. Since President Tony Tan revealed in May that the savings and annuity schemes under the CPF system would be improved, Singaporeans have had much to chew on, with various suggestions mooted by experts and Members of Parliament.

TODAY senior reporter Ng Jing Yng (today@mediacorp.com.sg) looks at three areas where changes may be afoot.

INTEREST RATES VS INFLATION

At an Institute of Policy Studies (IPS) forum last month, Manpower Minister Tan Chuan-Jin said the Government was studying how CPF returns could keep up with inflation, while noting that current interest rates of between 2.5 per cent and 5 per cent across CPF accounts act as a buffer against inflation to some extent.

Ang Mo Kio GRC Member of Parliament (MP) Inderjit Singh suggested pegging CPF interest rates to inflation, in addition to constant base rates. "The reason we are raising the Minimum Sum regularly is inflation and that ... savings are not growing fast enough to offset inflation," he said. "The cost of living is rising and what we felt was sufficient for retirement becomes insufficient due to the reduction of purchasing power."

Chua Chu Kang GRC MP Zaqu Mohamad called for a Government-backed investment plan that tracks inflation and yields returns above existing interest rates. The current CPF Investment Scheme, which allows CPF monies to be invested in an approved list of products, carries financial risks that a typical CPF member may not appreciate, he added.

Some observers cautioned that increasing CPF interest rates might mean dipping into the country's reserves or taxpayers' pockets.

Professor Benedict Koh, associate dean of Singapore Management University's Lee Kong Chian School of Business, said: "It is certainly not advisable for CPF to pay artificially high interest rates, which it can earn from financial markets ... such a strategy will not be sustainable in the long run and exposes the (CPF system) to risk of default."

However, Associate Professor Hui Weng Tat from the Lee Kuan Yew School of Public Policy (LKYSPP) said there was no need to touch the reserves. He suggested distributing Government surpluses — annual Net Investment Returns Contributions were about S\$8 billion for the past two years — to CPF accounts.

"No need to dig into reserves, just accumulate less ... In good years when



A direct consequence of reducing the CPF Minimum Sum may be lower monthly payouts for those in their golden years. TODAY FILE PHOTO

GIC returns are higher, they could also give bonus CPF returns above fixed returns on the SSGS (Special Singapore Government Securities)," he said.

It is precisely the need to take inflation into account that the Minimum Sum has been raised regularly — much to the chagrin of some CPF members.

The Minimum Sum — pegged to the Consumer Price Index (CPI), which measures inflation — is currently S\$155,000. Last year, about half of those who turned 55 had CPF accounts that met the Minimum Sum, including 15 per cent of active members who had pledged their properties.

At the IPS forum, Mr Tan said the imputed rental component used in the calculation of the Minimum Sum might be removed. Imputed rental is what homeowners would pay if they were renting their units.

National University of Singapore Business School professor Joseph Cherian said taking out the component would lower the CPI by between 0.5 and 1 percentage point a year. A back-of-the-envelope calculation showed that, based on the July 1, 2003 Minimum Sum of S\$80,000, the Minimum Sum on July 1 this year would be about S\$139,000, instead of S\$155,000, he added.

"My calculations are estimates based on recent historical records and provided to indicate it is good news that imputed rental may be taken out, given (that) almost 90 per cent of Singaporeans own their homes," he said.

Assoc Prof Hui, however, described

the suggestion as a red herring. Over the long term, the difference between CPI (all items) and CPI less imputed rental will be minimal, he said.

While property prices and rentals have escalated in recent years, the difference between CPI (all items) and CPI less imputed rental has been 2 percentage points over the past seven years — or 0.3 percentage point a year. Prior to 2001, inflation as measured by CPI (all items) was actually lower than CPI less imputed rental, he pointed out.

"If the property price speculation bubble is prevented by judicious policies, such as those that exist currently, there should not be any significant difference (whether imputed rental is included or not) ... The impact on the Minimum Sum computation would be negligible," he said.

A direct consequence of reducing the Minimum Sum may be lower monthly payouts for those in their golden years. Prof Cherian warned that the current S\$1,200 monthly payout is the bare minimum for a retiree to get by with no income.

Financial advisory firm Provident's CEO Christopher Tan said: "The risk is that if actual inflation is higher, we may not have enough in retirement and, by then, it would be too late to realise."

MORE OPTIONS AND FLEXIBILITY?

Deputy Prime Minister and Finance Minister Tharman Shanmugarat-

nam also said at the IPS forum that the Government could study ways to provide better options for CPF members who are able to take higher risks, so they may earn higher returns than under the CPF Investment Scheme.

An option that remains on the table is allowing members to use CPF monies to invest in private pension plans, he added. However, he cautioned that the options had to be studied carefully and people had to understand the risks involved.

The Government looked into allowing CPF members to invest in private pension funds in 2007, but decided against it as most members then had low balances and would not be able to absorb investment risks.

In a report earlier this month, Bank of America Merrill Lynch economist Chua Hak Bin noted that only 10.2 per cent of CPF balances had tapped the CPF Investment Scheme. Calling for private pension plans to be made available for CPF members, he said average CPF balances had risen from S\$37,100 in 2004 to S\$72,100 last year.

"Some CPF members want more flexibility and choices, and demand a higher rate of return than guaranteed rates", he added.

Ms Wong Su-Yen, chairman (Singapore) of financial services firm Marsh and McLennan Companies, pointed out that a one-size-fits-all approach was unlikely to meet the needs of all CPF members.

She noted that the guaranteed investment return — plus bonus interest after certain thresholds are achieved — under the current system is attractive to more conservative investors, "as it enables a solid risk-free yield that essentially provides purchasing-power protection".

To achieve higher rates of return, the key is to provide more choices and flexibility, and come up with an investment approach that is "suitable at various stages of life, given different members' risk profiles", she said.

She suggested creating a guided investment structure that provides options for members to invest in pre-structured portfolios. Under the structure, red flags would be raised if these selected portfolios were not aligned with an individual's risk profile, she said.

Prof Koh said CPF members could be given the option to invest in financial instruments that do not require much financial knowledge and have a high likelihood of generating high returns, such as target-date or life-cycle funds.

Greater flexibility to allow CPF members to draw down their savings has also been mooted. The observers agreed that the Government could consider a tiered approach, under which members could draw smaller portions earlier. However, this would mean less retirement funds for later years, they warned.

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ANG MO KIO GRC
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Conversely, people can choose to draw down their savings later and get larger payouts, LKYSPP's Assoc Prof Hui said. "(There can be) more options for CPF members to choose, but provided the amounts to be received are adequate for retirement living," he said.

In Parliament recently, West Coast GRC MP Foo Mee Har suggested removing the cap on what members must put aside for the Minimum Sum in their CPF accounts. Those who want to do so should be allowed to top up their accounts to get larger payouts in future under the CPF Life scheme, she said.

She noted that the S\$1,200 monthly payouts — under the current Mini-

mum Sum of S\$155,000 — might be insufficient for middle-income households. Not having to provide bequeathals and receive more payouts should also be option, she added.

In his reply, the Manpower Minister noted that the CPF Life scheme was still relatively new. The Government will "continue to look at it and see how best to improve it", he said.

HOUSING

With the elderly here preferring to age in familiar surroundings and given the prevalent mindset of bequeathing properties, observers called on the authorities to extend the Enhanced Lease Buyback Scheme to larger flats. Under the scheme, elderly flat-own-



Earlier this month, National Development Minister Khaw Boon Wan said a total of 367,000 households here had at least one flat-owner aged 55 years and above. TODAY FILE PHOTO

ers living in three-room and smaller flats can sell part of their lease to the Housing and Development Board (HDB) and retain a 30-year lease. Proceeds from the sale will go to their CPF Retirement Accounts.

However, only 326 households have signed up for this scheme since it was updated in February last year.

Speaking in Parliament earlier this month, National Development Minister Khaw Boon Wan said a total of 367,000 households here had at least one flat-owner aged 55 years and above. Of these, 32 per cent live in three-room flats, 44 per cent in four-room flats, and 24 per cent in five-room flats.

Mr Khaw said in February that the Government was considering expanding the criteria to include bigger flats. Pasir Ris-Punggol GRC MP Gan Thiam Poh said: "Most Singaporeans prefer to age in place as they are comfortable in their own homes ... They also want a bigger place so there is space when their children come back to visit."

To spur a higher take-up rate, Mr Zaqy and Prof Koh said, there had to be greater assurance on what happens when homeowners outlive the 30-year lease. Mr Zaqy noted that with the average person's rising life expectancies, the HDB has to explicitly state its policy for such a situation instead of handling it on a case-by-case basis. Prof Goh added: "The elderly eschew taking on longevity risk during old age ... The (HDB) should assume the tail risk on behalf of the owner ... This risk should be hedged against insurance."

To mitigate against a scenario where many elderly are asset-rich but cash-poor — a situation in which some seniors already find themselves — a few observers said the amount of CPF monies that is allowed to be used for housing should be moderated.

Currently, for example, first-time

homeowners of HDB flats can use CPF monies to make the 10 per cent down payment, the balance of the purchase price and the monthly instalment payments of the HDB concessionary loan.

Mr Singh said: "We should limit the amount allowable for housing but, at the same time, make houses more affordable."

Prof Cherian suggested further segregating CPF accounts based on uses. "Compartmentalising our life's needs in this manner may have a positive behavioural effect ... For instance, by compartmentalising funds for housing, there may be less of a temptation to buy a bigger home than one can afford," he said.

Currently, CPF savings go into three accounts: The Ordinary Account, where savings can be used to buy a home, pay for CPF insurance, investment and education; the Special account, to be used in old age and investment in retirement-related financial products; and the Medisave account, for hospitalisation expenses and approved medical insurance.

However, observers noted that any moves to further limit how much of one's CPF savings can be used for housing would have a profound impact on the market. Mr Zaqy said it could, for instance, lower demand and hit home prices, which will adversely affect homeowners.

Still, Prof Koh said the Government should rethink the policy of using public housing as a means of wealth accumulation. He said: "Should Singaporeans be holding almost all their retirement wealth in a single property whose value is subject to the vagaries of the property market? Should the housing market be segmented in such a way that public housing fulfils a housing need while private property market provides opportunities for wealth accumulation?"