Publication: The Business Times, p 12
Date: 13 May 2013
Headline: Knowing CPF, CPF Life and retirement

Knowing CPF, CPF Life and retirement

Use it or lose it: Pay down home loans with CPF OA monies before the age of 55, says **LARRY HAVERKAMP**

THE two most popular types of life insurance are to protect against dying too soon and living too long. We need both as humans are living longer than ever before.

Back in AD 100, during the Roman Empire, the average life expectancy was only 24. Of course, no one had life insurance back then, although the early Romans could have used it.

Today, life expectancy is 85 and one-third live beyond 90. We have term life insurance in case we die much sooner. Term life comes with insurance and no investments, which makes it an inexpensive way to protect the family against the loss of income should a breadwinner die.

Even less expensive is "decreasing term", where coverage declines as you near retirement, when you no longer need term coverage. Unfortunately, it is also less profitable for insurers, which probably explains why no insurer offers it in Singapore.

Insurance companies make the most money from selling "bundled" insurance like whole life and endowment policies. Those combine a little term insurance with a lot of investments, making it hard to figure out what you get or how much it costs.

These policies have sold well, and we have bought more bundled policies than the less expensive alternative of "buying term and investing the rest". That is half the insurance story. The other half covers the opposite risk, which is living too long.

Flexing financial muscles: *Learning to make your retirement nest-egg do the workout for you can mean a more fulfilling transition into the golden years.* FILE PHOTO

How much interest does CPF pay?

CPF ACCOUNT	INTEREST EARNED#	BONUS*	INVESTMENT CHOICES?
Ordinary (OA)	2.5%	1%	Yes
Special (SA) (to age 55)	4.0%	1%	Limited
Retirement (RA) (from age 55)	4.0%	1%	No
Medisave	4.0%		No

\# The lowest rate is 2.5% but even that is considered high, given that it is risk-free.
* The 1% bonus for OA, SA and RA applies to $60,000 including $20,000 from the Ordinary Account.

CPF Contributions

	FROM	TO		
	SALARY	ORDINARY ACCOUNT	SPECIAL ACCOUNT	MEDISAVE
Employee	20%			
Employer	16%			
Total	36%	21%	7%	8%

Note: • CPF contributions apply only to the first $5,000 of monthly income.
• Contributions from salary are to age 50, while allocations to OA, SA and Medisave are for ages 35 to 45. (Rates differ slightly for other age groups)

Living too long

Could it happen to you? Could you outlive your money and be forced to rely on the government in your declining years? What if the government is not so generous when your old age rolls around?

Singapore's solution is the Minimum Sum Scheme. It has replaced the CPF of the old days when you could simply take all the money in your CPF Ordinary and Special Accounts at age 55 and do what you pleased with it.

Fancy a Lexus? Many could suddenly afford it when they turned 55.

All that changed 26 years ago with the introduction of the Retirement Account. It permitted withdrawals more slowly – over 20 years, from age 60 to 80.

This changed again four years ago with CPF Life. It extends the payout period so that monthly payouts begin at age 65 and continue the rest of your life.

CPF Life began with four plans, which have been simplified to two.

From January 1 this year, CPF members are asked to choose between the Standard and Basic plans. The former allows more income with less bequeathed to beneficiaries. The Basic Plan does the opposite and pays a lower income with more going to your beneficiaries at death.

You have six months from your 55th birthday to choose your preferred plan. If you don't make a choice, the CPF Board decides for you and puts you in the Standard Plan, which is the default.

Minimum Sum

How much must you contribute to your CPF Accounts in order to have enough for your old age? From July, the Minimum Sum Scheme requires you to set aside $148,000 when you turn 55.

Suppose you haven't met it. Then what?

Don't worry. As long as you are a Singaporean or Permanent Resident, you will be placed on CPF Life provided you have $40,000 or more in your Retirement Account at age 55, which is when your Ordinary and Special Account balances are transferred to the Retirement Account.

One caution flag: At age 55, you become eligible to withdraw the money from your Ordinary and Special Accounts. But if you have not met the Minimum Sum plus the Medisave Required Amount, the money in your Ordinary Account will be transferred to your Retirement and Medisave Accounts to make up the shortfall. (You can still, however, withdraw up to $5,000.)

Is this a big deal? Why do you need money in your Ordinary Account anyway?

You may or may not need it. Everything depends on whether you rely on your Ordinary Account to pay your monthly mortgage.

If you do and it is suddenly drained to zero, you may find your cash is squeezed and you could even default on your home loan. If that's the case, then having zero in your Ordinary Account balance is a very big deal.

On the plus side, this is a one-time transfer. If you keep working after age 55, your Ordinary Account will begin building again and the new OA money can be used for housing.

Property pledge

The CPF Board realises this and has relented somewhat.

While you can't expect them to put the money back into your Ordinary Account, the CPF Board allows you to use what would otherwise become part of your Retirement Account for your housing needs.

How much? Up to half the Minimum Sum can be used, provided the other half has been set aside as cash. You do it by making a property pledge before you turn 55, if you own a property here in Singapore.

You and your spouse can each pledge up to half of your Minimum Sum obligation, which will be $148,000 by July 1 this year.

It means both you and your spouse can pledge $74,000 each, for a total of $148,000. That reduces your family's CPF Minimum Sum obligations considerably, such that you might have more money in the OA to use for housing after you turn 55.

An important requirement is that the property pledge must come from equity in your home, which is the property's value minus any outstanding charges like your home loan. In this example, your home equity would need to be at least $148,000 to make the maximum property pledge.

A big tip: At the most, a property pledge will cover only half your Minimum Sum. If it's not enough, the CPF Board will use your Ordinary Account to top up your Retirement Account. The money remains there – untouchable – until you turn 65. You can no longer use it to pay your mortgage.

From what I can tell, there is only one way to avoid this fate. It is to pay down your home loan using your Ordinary Account before you hit age 55. Remember to do it before your 55th birthday. One day later and the money goes out of bounds for housing.

However, do note that the downside of having less money in your Ordinary Account is a lower lifetime annuity.

Money not enough?

Is your CPF Life enough to see you through retirement?

Try an example: Suppose you don't make a property pledge and have set aside the full $148,000 minimum sum. Then you choose the Standard Plan. Will the monthly payouts you get, beginning at age 65, be enough to last the rest of your life?

Well, you can use the CPF calculators at www.cpf.gov.sg and go to the CPF Life Payout Estimator. The result you get depends on your age, sex and other variables, but it will probably come to around $1,100 per month.

Could you live on that?

It may look insufficient, but keep in mind that after age 65 (i) you will have few, if any, home loan payments left and (ii) you probably won't have to spend much on your children.

It may not be enough, however, if you have a lifestyle that requires more.

Just the same, it is reassuring to know you have a backstop of a certain income of $1,100 each month, come rain or shine, for the rest of your life.

Dr Larry Haverkamp is an adjunct faculty member at Singapore Management University and an instructor in the Citi-SMU Financial Literacy Programme for Young Adults

Source: The Business Times © Singapore Press Holdings Limited. Permission required for reproduction.