RETIREMENT - TIME FOR A MULTI-PRONGED APPROACH

Much fanfare has been given to retirement planning in recent weeks since Prime Minister Lee Hsien Loong announced changes to the CPF schemes. Financial Planning Expert David Choo offers his insight into a multi-pronged approach.

Retirement planning, one of the weakest pillars of financial planning for most Singaporeans, received a fillip in September 2005 when Prime Minister Lee Hsien Loong announced two changes being considered by the Central Provident Fund Board.

The two proposed opt-out schemes are:

1. The setting up of a pension fund in the CPF that will be invested in a range of investments with low fees and charges with the hope of getting more than the 2.5 per cent per annum in the Ordinary Account or the 4 per cent per annum in the Special Account.
2. Encouraging CPF members who turn 55 to purchase annuities instead of leaving their retirement "minimum sum" with the CPF.

There have been several papers written on the first scheme that is a replacement of the earlier proposed private pension plan. I will focus on a few of the broader issues of retirement in this article.

The two proposed schemes point to the fact that there are two phases to retirement planning: First, the savings and investment stage prior to retirement. Second, the wise investment of one's retirement savings to cater to the expected long retirement years attributed to Singapore's rising longevity.

There are five challenges when we address the question of retirement:
First, for the majority, the retirement saving at age 55 is just not enough. Almost two thirds do not even have the required minimum sum of $90,000 today.

Second, for those with the required minimum sum, the preferred choice is to leave it with the CPF because they get a larger monthly sum of $711 from age 62 compared to what they would get from putting the money with the bank or purchasing an annuity. One insurance firm pays $483 per month. Whether leaving money with the CPF is the right choice will be examined in detail. Also, what must the CPF and the government do to encourage more to purchase annuities? Just having an opt-out scheme without improving the annuity payments would be interpreted as banking on CPF members' ignorance and inertia.

Third, the Supplementary Retirement Scheme (SRS) is just not attracting enough of the younger ones. Can anything be done to make it more attractive? There should be more incentives to induce the young to take up this scheme.

Fourth, outside of the CPF, what encouragement can be given for private savings for retirement?

Finally, what encouragement can be given to employers to set up employer-sponsored schemes? Again, alternative options (similar to pension schemes in the United States) like employer-sponsored schemes should be introduced, with employers getting incentives and tax benefits.

MONEY NOT ENOUGH

The first problem of the majority of Singaporeans not having sufficient money for their retirement is due to two factors. Firstly, some earn low salary or earnings and correspondingly are only able to make small contributions to their CPF. The second reason is that most Singaporeans do not have sufficient savings of their own apart from the CPF. A very large chunk of Singaporeans' earnings go to their properties.

For others who have more disposable income, current spending is generally preferred over savings for the future. Making one's savings work harder by trying to get better returns is good for those who have savings. But for the others who are currently not saving enough, the challenge is to be more prudent and have a regular savings plan. From a financial standpoint, many ought to get rid of their cars and take public transport and save and invest the difference.

The CPF can only do what it can with the savings in the CPF. Judging from statistics, investors using the CPF Investment Scheme have not done well. From 1993 to 2004, three quarters would have done better if they had not use their CPF money for investments. This is partly due to their poor judgment in investments and also the relatively higher charges that they had to incur when investing individually.

The concept of a pooled investment with lower charges is a good way for the small CPF account

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holders to realise better returns but certain risks have to be faced. But the greater need is for lower income Singaporeans to increase their savings for retirement through more prudent money management.

ANNUITIES FOR RETIREMENT

The present situation of the CPF offering 4 per cent per annum on retirement funds left in the CPF Minimum Sum Scheme vis-à-vis the 2.5 per cent interest rate used in most annuity computations has led to many Singaporeans leaving their retirement fund with the CPF. A retiree at age 55 with a minimum sum of $90,000 can expect to get about $711 every month from age 62 onwards to age 82. If the same retiree purchases an annuity today with his $90,000, he will only get $483 from age 62 onwards from one insurance company. Although he stands to receive this same amount for as long as he is living, this is a big drop from the $711 per month he would have got from the CPF.

Is it worth it to purchase annuity under these circumstances? Consider that the retiree can save the difference of $228 per month on a savings or investment plan that could give a return of about 3 per cent per annum conservatively in a unit trust over 20 years. The amount that will be accumulated at age 82 is $75,722. This amount can be used to purchase an annuity then if he is still alive and well. At today's rate, $75,722 at age 82 will buy an annuity of $544.75 per month to the end of his life.

Given this situation, the only way the CPF can convince CPF retirees to withdraw their CPF MSS and buy annuities is for either the CPF interest rate to go down (hopefully not) or the annuity interest rate to increase. If the annuity interest rate can increase to 4 per cent, most Singaporeans would likely opt to buy annuities. And why not 4 per cent?

It is difficult to understand why insurance companies cannot offer better interest rates for annuities. Perhaps it is due to restrictions on what they can invest in and also the high cost of setting aside additional capital or reserve to cater to the long-term payouts in annuity schemes.

One way out is to have variable annuities with a fixed guaranteed return and an additional variable return like NTUC. But CPF retirees would definitely prefer guaranteed annuities and fixed payments. If the CPF can pay 4 per cent per annum, insurance companies should be able to do so also if given sufficient volume. Perhaps, a tender can be called to award to the two best firms like the case of Eldershield.

SRS

SRS often is not within the radar of many people because it appeals mainly to those who stand to gain from the tax savings. The earliest withdrawal age of 62 and the penalty for withdrawal before then also makes it less attractive for the younger ones who are likely to use their savings for more urgent needs. In the end, SRS seems to be a boon for those who already have much stacked up. One way to encourage the younger ones to sign up is to give monetary incentive direct to their SRS account pegged to the savings put in by the individual.

PRIVATE SAVINGS FOR RETIREMENT

Outside of the CPF, what can the government do to encourage more savings for retirement? SRS is one way and has its supporters and detractors. One other way is to allow Singaporeans to volunteer to save more through voluntary contributions to their CPF account up to a certain percentage. These contributions should be tax deductible and be administered by the CPF. It should be beyond the minimum sum allowed as this is not enough for ample retirement.

EMPLOYER-SPONSORED SCHEME

Firms that are doing well and want to reward and keep their good staff should be encouraged to set aside deferred compensation for their employees as a form of retirement benefits. These retirement benefits which could be paid at age 62 should be tax deductible expense to the firm and preferably not taxable at the hands of the employees. Limits could be set in percentage or quantity terms. If desired, the employer's contribution can match voluntary contribution from the employees.

CONCLUSION

Singaporeans are faced with the twin challenges of longer life span and smaller families. Retirement should be a reward for the years of hard work but now looms ahead as impending disaster unless adequate savings are accumulated. CPF savings is one way, and the proposed pension fund plan would go some way to provide better returns, and the proposed annuity route ensures that no one outlives his money. But more needs to be done as the minimum sum is inadequate. A more comprehensive approach should be adopted. SRS is not achieving its intended objective. More should be done to encourage private savings and employer-sponsored schemes. Retirement is not just a matter for the individual to solve but a potential social problem which requires a multi-pronged solution. **SI**

(David Choo, ChFC, CFP, is the Managing Director of PromiseLand Independent Pte Ltd, a licensed Financial Adviser. He can be contacted at email: davidchoo@promiseland.com.sg or telephone no. 62942461.)