Realistic ways to raise CPF returns

Seng Kee Benedict KOH
Singapore Management University, skkoh@smu.edu.sg
Realistic ways to raise CPF returns

By KENDEL KOH FOR THE STRAITSTIMES

SINGAPORE is a fast-ageing nation due to declining fertility rates and the increasing life expectancy of its citizens. The impending ageing tsunami places a heavy burden on the Central Provident Fund (CPF) to be the primary vehicle to generate citizens' retirement income.

But is the system working in the best possible manner?

There have been grumblings in social media recently about the inadequacy of CPF’s compulsory savings scheme. From 2008 to 2012, the percentage of CPF members attaining the required minimum sum for CPFIS has fallen from 74.3 per cent to 48.7 per cent. In other words, less than half of CPF members have the minimum sum.

This minimum sum is essential to a retirement account. It is created by transferring savings from other accounts (often used for housing and education of children) held by CPF members, a citizen or permanent resident turns 55, intended to be sufficient to support a subsistence level of living in old age. This minimum sum can only be accessed at age 65. Increased regularly to keep pace with inflation, it currently stands at $148,000. In Italy, it will be raised to $35,000.

The key reason many do not have the minimum sum is in their retirement savings. CPF members have contemplated the bulk of their retirement savings, which may be a regrettable decision. A study by the author and others, published in the Journal of Social Security in 2009, found that 64 per cent of CPF members who leave the system do not have the minimum sum invested in properties.

Another solution is to help CPF members prevent their capital from being eroded by economic downturns.

CPF Investment Scheme

CURRENTLY, CPF members who are willing to take risks to earn a higher return on their contributions can invest their money through CPFIS. This scheme allows them to invest part of their savings in a wide variety of financial instruments that could potentially yield a higher yield than the default CPF savings scheme.

While the CPFIS is open to all members, the 2008 study found that only 12 per cent of Ordinary Account (OA) savings and 20 per cent of Special Account (SA) savings were committed to invest. MenStats indicate that the participation rate in CPFIS is low. Possible reasons for leaving money in the SA include the relatively high guaranteed annual interest rate of 4 per cent, and an unwillingness to risk retirement savings. However, these may not be the only reason. The research indicated that the reasons for the low investment in CPFIS are the financial intermediation works. CPFIS members’ savings in the Ordinary Account (OA) and Special Account (SA) are set aside for the benefit of members who leave their savings in banks. Depositors who leave their savings in banks do not demand high returns. Instead, they are willing to settle for a low interest rate in exchange for security. They cannot demand the returns earned by banks because they are not the ones putting capital at risk. Likewise, CPF members who leave their savings in default investments are not entitled to the returns earned by banks. Such an investment strategy is certainly not prudent for CPF members, especially when they are nearing retirement.

The study also revealed that CPFIS members tend to hold risky investments. For example, the global financial crisis in 2008, almost all professionally managed funds and sovereign wealth funds lost money. Such an investment strategy is certainly not prudent for CPF members, especially when they are nearing retirement.

The CPF Board should consider it to be a low-cost, low-risk managed life-cycle funds to participate in the CPFIS.

CPFIS are funds that can be invested in a variety of financial instruments that can potentially yield a higher yield than the default CPF savings scheme.

Irrational to expect both low risk and high returns

The low interest paid on CPF balances compared with the relatively high returns earned by government investment entities such as Temasek Holdings and GIC is a common gripe. CPF members currently have a choice of either investing the savings themselves or leaving them with the CPF Board. For the former, they can invest in a rich menu of instruments from the CPF Investment Scheme. The latter earns guaranteed interest on the central account.

Since the CPF has a duty to safeguard members’ savings, it is prudent for it to purchase low-risk instruments that generate stable cash flows. The safest instrument without an exchange-rate risk is Singapore government bonds which are rated "AAA". This allows the CPF Board to guarantee interest payments to its members. When the Government issues bonds, it borrows from the CPF. The CPF is able to offer lower interest rates due to its status as a Government agency.

The Government issues bonds, it borrows from the CPF. The CPF is able to offer lower interest rates due to its status as a Government agency. When the Government issues bonds, it borrows from the CPF. The CPF is able to offer lower interest rates due to its status as a Government agency.

The CPF Board also manages a capital preservation fund to provide members with a minimum sum of $58,000. This fund is invested in a diversified portfolio of assets, including government bonds and other low-risk investments. The fund is designed to provide a stable source of income for members near retirement.

The CPF Board also manages a capital preservation fund to provide members with a minimum sum of $58,000. This fund is invested in a diversified portfolio of assets, including government bonds and other low-risk investments. The fund is designed to provide a stable source of income for members near retirement.

The CPF Board also manages a capital preservation fund to provide members with a minimum sum of $58,000. This fund is invested in a diversified portfolio of assets, including government bonds and other low-risk investments. The fund is designed to provide a stable source of income for members near retirement.

The CPF Board also manages a capital preservation fund to provide members with a minimum sum of $58,000. This fund is invested in a diversified portfolio of assets, including government bonds and other low-risk investments. The fund is designed to provide a stable source of income for members near retirement.

The CPF Board also manages a capital preservation fund to provide members with a minimum sum of $58,000. This fund is invested in a diversified portfolio of assets, including government bonds and other low-risk investments. The fund is designed to provide a stable source of income for members near retirement.