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CPF: Meeting challenges with minor alterations

By **ROHIT GUPTA**

WE are fortunate to be living in a country whose social security plans are among the best in the world. Its Central Provident Fund (CPF) scheme covers housing, medical and retirement income. It has individual accounts (the more you contribute, the more you get), and is an advance-funded (versus pay-as-you-go) scheme, ensuring that the scheme does not put pressure on the taxpayer.

While the scheme has been broadly successful, we have of late seen some discontentment. In terms of ability to own and pay for their homes, Singaporeans boast a home ownership rate that is among the highest in the world. On healthcare, a recent advertisement in the MRT stations sums it up clearly: "Singaporeans live longer than the British but have lower healthcare costs".

The issues relate to adequacy of retirement savings. While the public discourse has focused on lump-sum withdrawals and higher interest rates, these have to be balanced against adequate retirement funds and prudent guaranteed payments by the government.

The challenge really is to balance the competing objectives of housing, retirement and medical needs. A proposal: Align the accounts to separate needs and ensure adequate funds in each to meet specific needs. A key consideration here would be to reduce the proportion for housing and increase contributions towards retirement.

Clearly, these are complex issues, impacting people differently, and changes can have unintended consequences. However, here are a few suggestions for consideration:

1. Accounts

Change the names of Ordinary Account, Special Account and Medisave to Housing Account, Retirement Account and Medical Account, respectively.

While it may seem to be semantics, this may help better align the account to usage (and ability to withdraw funds).

2. Contribution rates

Rebalance the contribution rates across the three accounts. Marginally lower the rate for the Housing Account and proportionately increase the contribution to the Retirement Account – and keep the overall contribution rate unchanged.

This would help discourage over-investment in property as well as ensure adequate savings for retirement. Most financial planners recommend saving about 10 per cent of income towards retirement.

For CPF members below 35 years of age, lower the contribution towards the Housing Account from 23 per cent to 20 per cent, and raise the contribution towards the Retirement Account to 9 per cent, from 6 per cent. No change to the total CPF contribution rate of 36 per cent.

At the same time, do not reduce the Retirement Account contribution rates for members over 50 years. In fact, as most of them would have paid off their mortgages, their Housing Account rates can be lowered while maintaining the (lower) total contribution rates.

Not least, consider raising the S$5,000 monthly salary cap for CPF contributions.

3. Interest rates

Pay a lower interest rate on the Housing Account but increase the interest rate on the Retirement Account and Medical Account.

An incremental rise in interest rates can go a long way towards growing retirement savings via compounding over a longer term. Do not subsidise property investment but encourage instead the build-up of retirement savings. Consider also removing the S$60,000 cap on the incremental one per cent interest rate to encourage savings.

4. Withdrawals

Any funds in the Housing Account should be allowed to be withdrawn, while funds in the Retirement Account would automatically be converted to an annuity (CPF Life), providing a guaranteed income.

These changes should help address the recent concerns on lump-sum withdrawals and retirement savings while staying true to the core philosophy which has stood Singapore in good stead.

Core philosophy

- Self-reliant, individual accounts and advance-funded
- Meets three specific requirements for (i) housing, (ii) retirement and (iii) medical

Key challenges

- Restrict over-investment in property at the expense of retirement funds
- Provide some flexibility for members to withdraw funds without depleting retirement funds

The writer has 25 years of international banking experience. He has a passion for consumer financial education, and has a Web portal (www.yourrule72.com) and a blog page on BTInvest (http://www.btinvest.com.sg/blogs). The views here are made in his personal capacity