

## **MINISTERIAL STATEMENT ON CPF REFORMS AND OTHER MEASURES FOR A SECURE RETIREMENT**

### **1 Introduction**

1.1 The Minister for Manpower, Dr Ng Eng Hen, has provided a comprehensive explanation of the changes to the CPF scheme, including the changes in interest rates, aimed at giving members better security in retirement and old age.

1.2 MOF's responsibility is to ensure the changes made to the CPF scheme are reasonable in relation to market-based returns and hence fiscally sustainable.

1.3 We also have to satisfy the President that the CPF changes are indeed affordable in the long run and that they will not result in a draw on past reserves. The President has to be satisfied that we are not paying unjustifiably high returns on CPF balances that must lead to a draw on reserves.

1.4 Some MPs have asked, if Government should pay more on CPF balances. They have asked for Government to pay higher interest rates than what Eng Hen has announced, or to pay a guaranteed floor of 4% on the SMRA accounts indefinitely. Several have asked for Government to foot part or all of the bill of providing for Singaporeans in old age.

1.5 I will address these issues from the perspective of the government's finances.

### **2 CPF interest rate changes are reasonable and justified**

2.1 MOF is satisfied that the re-pegging of the SMRA rate and the extra 1% on the first \$60,000 of CPF balances will result in interest rates which are fair and reasonable to members, and also sustainable over the long term. The changes will provide members with a justified rate of return, based on investments of similar risk profile and duration. They will also ensure that the scheme remains affordable over the long term.

2.2 Our fundamental principle must be to peg CPF interest rates to those in the financial markets, to instruments of comparable risk and duration. This is because the government's ability to pay interest on CPF balances will also depend on financial market conditions. For the CPF scheme to be sustainable, not just now, but in the decades to come, it should not become an interest rate subsidy scheme.

### **3 Moving SMRA to 10YSGS +1%**

3.1 Let me specifically address the issue of the SMRA rate, which several MPs have spoken about.

3.2 We have studied the appropriate peg for the new SMRA rate thoroughly. As Minister Ng has explained, we ideally want a 30 year SGS bond rate. The question is, in the absence of a 30 year bond in SGS markets, what is the best proxy for this long term rate.

3.3 We decided to use the 10YSGS bond as a peg, with an additional spread of 1% to approximate the 30Y bond rate. Why the 10YSGS? It is the most liquid and actively traded part of the SGS bond market. (It also matches the most liquid part of the US Treasury market, which is used by fund managers and banks to manage their SGS exposures)

3.4 Why a 1% spread on top of the 10YSGS rate? A 1% spread is in fact somewhat larger than what the international markets have been paying on 30 year bonds. The

US and Euro Area markets have seen a spread of 30 to 40 basis points on average for the last decade or more. In Switzerland, the spread has been 70 to 80. In Japan, the spread is higher at 80-90 basis points over the last decade.

3.5 So the spread varies but the 1% spread that we are applying on the 10YSGS rate is higher than what has been observed historically in the developed markets. This may seem a little generous for now, but it gives adequate allowance for future economic and market uncertainties. For example, if inflation picks up globally, we can expect higher spreads over time on long term bonds. MOF therefore believes that the new SMRA rate is fair and reasonable for the long term.

#### **4 New SMRA rate**

4.1 The new SMRA rate is a more rational scheme than the old one, which provided an arbitrary fixed premium of 1.5% over a short term interest rate peg. This was why the ERC had proposed that we peg SMRA rates to long term bond returns in 2002.

4.2 By pegging to market based long term bond rates, the SMRA can offer members better returns over time with slightly higher interest rate risk. By any reasonable assessment, the new rate of 10YSGS plus 1% offers a very fair long term return for deposits which have no risk of losing their value (no capital risk, no currency risk).

4.3 Inderjit had suggested that the new interest rates will leave Singaporeans worse off. This is not the case. In the short term, the new SMRA formula, together with the 1% extra interest tier, will mean that members with balances of \$60k or less, (more than 80% of all members), will immediately be earning 5% on all their SMRA monies once the changes are implemented.

4.4 For larger balances, there is no change in the SMRA rate in the short term. No one can say for sure what interest rates will be five or ten years from now. There will be some years where the SMRA interest rates fall below 4%. But there is no reason to believe that on average, the new SMRA rate will be inferior to what is provided in the current formula which is pegged to short term interest rates.

4.5 This has in fact been the case in the past. The 10YSGS + 1% was 4.5% on average over the last decade. It has also been above 4.0% 85% of the time.

4.6 It is also the case if we look at what the pricing in financial markets implies for the future. If we look at what the markets currently expect for the future, it is for the 10YSGS rate to be above 3.0% on average over the next five to ten years, and hence for the new SMRA rate to be above 4.0%.

4.7 Any scheme to provide higher returns must come with higher risk. The new SMRA peg offers the prospect of better returns over time, with slightly higher interest rate risk. For the majority of members who have smaller SMRA balances, the extra 1% interest tier should more than offset the interest rate risk.

4.8 Taken together with the new floor of 3.5% on the first \$60k of members' balances, this is a fair scheme, designed to provide the majority of citizens with good returns at low risk.

#### **5 Funding the changes**

5.1 Dr Ahmad Magad, Mr Seng Han Thong and Mr Lim Wee Kiak had rightly asked about the sustainability of the changes, including the cost of the Workfare enhancements, and the Deferment and Voluntary Deferment bonuses.

5.2 The changes to the CPF interest rates will cost \$700 million, per year. The CPF

board will pay for this through the interest it receives on the bonds it purchases from the government. Government's debt servicing cost will therefore increase, and we will have to meet this through returns on investing the CPF monies. This is why we must avoid paying above market rates for CPF interest. Paying market rates will be the only way in which we ensure that the CPF is sustainable not just for the next few years but the very long term. It keeps the CPF as a self-sustaining savings scheme that does not result in the Government running deficits. It should never become a draw on past reserves.

5.3 This is also why we should not provide a 4% floor for SMRA rate indefinitely. To do so would amount to providing members with the upside of a market based rate but with the Government underwriting any downside. This will be unwise and untenable for the long term. Our whole approach must be to make sure that the scheme can be sustained. This will not be the case if the CPF becomes an interest rate subsidy scheme.

5.4 What we are subsidizing, is the WIS. It is a social scheme, an explicit subsidy that we put on our budget, and which we will have to fund from our budget. This is more than \$400 million per year.

5.5 We are also paying for the Deferment and Voluntary Deferment bonuses, as a subsidy. \$1.2 billion over ten years. This too, we put on the government budget. It is temporary but we have to fund it on the budget.

5.6 That's our approach – put any subsidies on the government budget, and make sure that we can afford them.

### **Fiscal Strategy**

5.7 The changes to the CPF and to Workfare are part and parcel of the broader fiscal strategy that we have discussed in this year's Budget.

5.8 We are making preparations now for the challenges of an ageing population, especially in terms of healthcare spending and providing for the needs of older Singaporeans. We are strengthening our social security system through Workfare, to ensure that the lower income are not left behind. And we are building capabilities for the future through education and R&D, reducing taxes to remain competitive and rejuvenating our housing estates, and our city landscape. This is why we raised GST by 2% this year, and why we plan to amend the constitution to make available more investment income for spending, on the budget.

5.9 The increase in GST revenues, together with the additional income from our reserves in the future, will give us the resources to enhance our social security system and provide a secure future for Singaporeans young and old.

5.10 Mr Inderjit Singh had called for government to use its reserves.

5.11 It will not be wise for Government to do this, or for Singaporeans to want their Government to do this.

5.12 We know that these pressures will build up over time, for Government to spend more, grant more, to subsidise more. It is precisely these pressures that we anticipated when we decided to put in place the Elected Presidency system. It is a system that makes sure that subsidies are paid for and funded on the budget now, one way or another, and not left to future generations to pay. This is the way we must run Government. There is no easy way out.

5.13 Inderjit spoke about Temasek's past returns. Siew Kum Hong added in GIC's returns. It would be unwise to forecast future returns for either Temasek or GIC on the basis of past returns. This has to be a disciplined process of assessing the

investment environment, looking forward to the next 5 to 10 years, relooking assumptions every year, and projecting what we can realistically expect in investment returns. What GIC expected last year, this year or next year, may not hold three years from now. But if the Government should indeed expect to continue to make good returns on investments, this will be reflected in the Budget, and we will then decide on the most prudent use of these resources. The money does not disappear.

5.14 The Government has in fact been using budgetary resources to help Singaporeans build up their savings. The majority of Singaporeans already enjoy a substantial housing subsidy through HDB, funded from the budget. Lower income Singaporeans get an additional housing grant. Workfare is the other way – also a subsidy that helps low income workers save more. A substantial part of a low income worker's CPF balances and housing equity, both of which comprise what he can draw on to meet his retirement needs, will be attributable to the CPF housing grants and Workfare. The World Bank study, cited by Siew Kum Hong, or any other study, will not find a system that provides such substantial support to build up the savings of workers, and especially for lower income workers.

5.15 This is the way we have done it. When we have surpluses, we spend it on worthwhile investments and services for our citizens, in housing, education or healthcare, or in Workfare, or return it to citizens as we have done before with CPF top-ups.

5.16 But what is absolutely critical in all of this is the culture that underpins our economic strategies for the future. This is the ethic of self-reliance, where every Singaporean knows and understands that he has to save for his future needs. Both Josephine Teo & Heng Chee How underlined the importance of this culture today. Our economic strategies depend on this culture, both to secure growth, and to secure the cohesive society that Low Thia Khiang spoke about today. Let's not erode this.

5.17 This is why the approach that we have taken is to give Singaporeans incentive to work and save on their own. If you work and save, we will help top up your savings.

5.18 But this approach of helping Singaporeans to save for retirement, is quite different from Government taking over and providing for everyone's retirement. In other words, providing an assurance that no matter how much you save, the Govt will be there to provide for your retirement. If we do that, there will be less and less reason for people to save. This is what has happened in many countries, where people save less, knowing that the Government will pay. This is why many countries have ended up with very high taxes and unsustainable pension schemes.

## **6 Conclusion**

6 Mr Speaker, Sir, MOF is confident that the CPF changes we are putting in place will be fiscally sustainable.

that the CPF changes will not cause a draw on past reserves. Ours is a disciplined and sustainable approach, which will ensure that whatever we do now will last, not just for a few years but for generations to come.