

REFOCUSING THE CPF SYSTEM
FOR ENHANCED
SECURITY IN RETIREMENT AND
ECONOMIC FLEXIBILITY

ECONOMIC REVIEW COMMITTEE:
SUB-COMMITTEE ON POLICIES RELATED TO
TAXATION, THE CPF SYSTEM, WAGES & LAND

CONTENTS

| | Page |
|---|------|
| PREFACE | 1 |
| EXECUTIVE SUMMARY | 2 |
| SUMMARY OF KEY RECOMMENDATIONS | 12 |
| CHAPTER 1 RECENT DEVELOPMENTS AND FUTURE CHALLENGES | |
| - Recent Developments | 16 |
| - Enhancing Financial Security in Retirement | 17 |
| CHAPTER 2 KEY PRINCIPLES FOR A REFOCUSSED CPF SYSTEM | 20 |
| CHAPTER 3 RETIREMENT ADEQUACY | |
| - CPF Minimum Sum Scheme | 22 |
| - Setting Aside More in the Special Account | 22 |
| - Increasing the Minimum Sum to Cater for Higher Living Standards | 23 |
| - Maintaining Stability of CPF Contribution Rates | 23 |
| CHAPTER 4 HEALTHCARE ADEQUACY | |
| - Introduction | 24 |
| - Current Situation | 24 |
| - Strengthening Provisions for Healthcare Needs | 25 |
| CHAPTER 5 HOME OWNERSHIP | |
| - Encouraging Prudent Withdrawals for Housing | 27 |
| CHAPTER 6 ENHANCING RETURNS ON CPF BALANCES | 29 |
| CHAPTER 7 ENHANCING LABOUR MARKET FLEXIBILITY | |
| - Reducing Mandatory Contributions for High-Income Earners | 32 |
| - Giving Low-Income Workers More Take-Home Pay | 33 |
| - Enhancing Wage Flexibility and Employability for Workers Aged 50-55 | 33 |
| - Upgrading Skills | 34 |

| | | |
|------------------|---|-----------|
| | - Removing Rigidities in the Wage System | 35 |
| CHAPTER 8 | CONCLUSION | 38 |
| | ANNEXES | |
| A. | CPF Schemes | 39 |
| B. | Details Of CPF Schemes Related To Housing | 40 |
| C | Composition of the Sub-Committee and Working Groups on CPF and Wages | 42 |
| D | Secretariat (CPF and Wages Working Group) | 48 |

PREFACE

The Economic Review Committee (ERC) was convened in December 2001 to review Singapore's development strategy and formulate a blueprint to restructure the economy. The Sub-Committee on Taxation, Wages, CPF and Land was set up as part of the ERC to review Government policies with economic implications, including taxation, the CPF system, land allocation and the framework for wage competitiveness.

The recommendations on the CPF system are the second major set of proposals from the Sub-Committee. These recommendations are based on the work by the Working Groups on the CPF System and on Wages, and are reflective of the balanced emphasis on retirement security, home ownership as well as economic flexibility.

EXECUTIVE SUMMARY

REFOCUSING THE CPF SYSTEM

1. The CPF system is fundamentally sound. Since its introduction in 1955, CPF has provided Singaporeans with a framework to save for their own retirement, reflecting our strong emphasis on individual responsibility. The role of CPF has grown over the years – today it addresses both retirement and healthcare needs, and has also enabled the vast majority of Singaporeans to purchase their own homes.
2. Moving ahead, CPF should continue to cater to the **three key needs of retirement expenditure, healthcare and home ownership**. CPF should endeavour to meet these needs **at a basic level**. The CPF should focus on the **broad majority of the population, between the 10th and 80th percentiles of the income spectrum**.
3. As a mandatory scheme, the CPF should be rolled back where it is not necessary, or where it does not meet its intended objectives. Those in the lowest income group (10th percentile and below) cannot rely on CPF alone for their retirement needs. To do so would require higher levels of CPF contributions which would leave them with too little take-home pay for their current consumption needs. Other social support schemes and policies will be required to supplement the CPF framework for this group.
4. At the top end, for households with incomes above the 80th percentile, there is no need to impose on them the same percentage of mandatory savings as for the rest of the population. Those in this group are well able to look after their own financial affairs, and should be encouraged to take greater responsibility for their own financial planning, including planning for their retirement needs. We therefore propose to set the ceiling on CPF contributions at no more than the 80th percentile income level.
5. Changes to the CPF system must be made gradually. CPF members have made long-term commitments based on the current framework, and must be given time to adjust to any policy changes. Our approach in this current review is to mark out the broad path that the CPF should tread in the future and allow these changes to set in steadily, rather than to introduce drastic changes that could shock and destabilise the system.

6. The implementation of many of our recommendations is linked to the restoration of the CPF contribution rate to 40%. When and how quickly this is achieved is beyond the remit of the Sub-Committee. However, we envisage it taking place over the next 2-4 years, depending on the state of the economy. There should thus be ample time for the system to adjust and for Singaporeans to adapt to the changes being proposed.

I. ENHANCING FINANCIAL SECURITY IN RETIREMENT

Challenges of Adequacy

7. Many CPF members today are “asset-rich and cash-poor” at retirement. This imbalance arises mainly because of large withdrawals of CPF money for property purchases.

8. It is rational and sensible for Singaporeans to invest in property. Not only does this provide their families with a roof over their heads, it also gives them a substantial asset that offers added financial security in retirement. CPF members should not be deterred from investing in housing for their retirement, as long as they do so prudently.

9. However, as our society ages, Singaporeans will need more flexibility to convert the homes they own into income to help meet retirement needs, such as through reverse mortgages, subletting their flats, and downgrading. The Sub-Committee recommends that the Government explore ways to make it easier for homeowners to monetise their property. However, even if the mechanisms are available, not all Singaporeans will be in a position to monetise their property. We also need measures to help members increase their CPF cash balances and reach the Minimum Sum.

10. Changes in social and demographic trends in Singapore mean that future retirees cannot rely on their children to the same extent as today’s retirees. With longer life expectancies, families with fewer children, and a growing proportion of unmarried retirees, future generations will have to depend more on their own CPF savings for financial security.

Setting Aside More in the Special Account

11. The Government has committed to restore the CPF contribution rate to 40% from the current 36% as soon as economic conditions allow. It has also committed to increase the Special Account (SA) contribution rates from the current 4/6/6 (4% for members 35 years and below, 6% for members above 35 to 45 years, and 6% for members above 45 to 55 years), to 4/6/8 as the total CPF is restored to 40%.

12. However, the SA rates need to be increased beyond 4/6/8 in order to meet future retirement needs. Even at 4/6/8, many members will have difficulty meeting the Minimum Sum, which will be \$80,000¹ from July 2003. At SA contribution rates of 4/6/8, the Sub-Committee projects that only about 50% of new members with a full career of CPF contributions would reach at least \$80,000 in cash by 55, or \$40,000 after half the cash is withdrawn.

13. To boost their SA savings and help more members reach the Minimum Sum, we propose to **increase the contribution rate to the Special Account by a further 1%-point to 5/7/9 as we restore the overall CPF contribution rate to 40%**, as shown in the table below. This will increase members' SA balances by about 20%, and enable an additional 10% of all members to reach the Minimum Sum by 55.

Table 1: Special Account Contribution Rates

| Age of Member | Current Rate (%) | Announced Rate upon CPF Restoration (%) | Recommended Rate upon CPF Restoration (%) |
|-----------------------------|------------------|---|---|
| 35 years and below | 4 | 4 | 5 |
| Above 35 and up to 45 years | 6 | 6 | 7 |
| Above 45 and up to 55 years | 6 | 8 | 9 |

Increasing the Minimum Sum to Cater for Higher Living Standards

14. The CPF Minimum Sum cannot remain static. As the economy grows and wages rise, successive cohorts of Singaporeans will have higher expectations of what they consider basic in retirement. Over time the present Minimum Sum will become insufficient for the majority of retirees.

¹ Currently, up to \$40,000 can be in the form of a property pledge.

15. We recommend that **as wages rise over time, the Minimum Sum should also be increased in step, beyond the \$80,000 which will take effect next year.** This will have to be phased in gradually, as many members do not have sufficient CPF balances to meet even the existing Minimum Sum today.

Strengthening Provisions for Healthcare Needs

16. Besides retirement income, the CPF also needs to provide more for healthcare needs, the bulk of which is likely to be required during retirement. There are strong upward pressures on healthcare costs. To help Singaporeans better prepare for their healthcare needs in retirement, the Sub-Committee supports the Government's intention to **increase the contribution rate to the Medisave Account (MA) by 1%-point when the total CPF contribution rate is restored to 40%,** as follows:

Table 2: Medical Account Contribution Rates

| Age of Member | Current Rate (%) | Recommended Rate (%) |
|-----------------------------|------------------|----------------------|
| 35 years and below | 6 | 7 |
| Above 35 and up to 45 years | 7 | 8 |
| Above 45 years | 8 | 9 |

17. We also support the Government's intention to **move towards greater risk-pooling through insurance to complement Medisave** and improve the efficiency of financing healthcare expenses. Greater risk-pooling through MediShield will improve insurance coverage for Singaporeans. The current framework of co-payments and deductibles should also be retained so as to avoid over-consumption of healthcare and reinforce personal responsibility for healthcare.

18. To generate healthy competition in the provision of health insurance, thereby boosting provider quality and keeping costs down, the Government should **consider devolving MediShield and other CPF-based insurance schemes, such as the Home Protection Scheme and Dependants' Protection Scheme, to private insurers to operate and manage.** This would be similar to the way in which the Government has allowed private insurers to operate ElderShield.

Encouraging Prudent Withdrawals for Housing

19. The Ordinary Account (OA) should allow members to own a home commensurate with their income, and provide additional savings to supplement the retirement income provided by the SA. As housing absorbs a large part of the OA savings of many members, we need **to ensure that withdrawals for housing are not excessive in relation to the property value.**

20. When the Residential Properties Scheme for purchases of private property was first introduced in 1981, withdrawals of CPF savings were limited to 80% of the initial purchase price of the property (i.e. a “Valuation Limit” of 80%) to protect members against any drastic fall in property prices. However, this was liberalised over the years. As a result, the current limits on the amount of OA funds that can be withdrawn for purchase of a particular property are very lax. OA funds can be used to repay both the principal and interest on a mortgage loan, even to the extent that OA withdrawals far exceed the value of the property. For example, total OA withdrawals by a homebuyer to pay for both the principal and mortgage interest could reach 160% of the initial purchase price by the end of a 25-year loan.

21. We propose to cap OA withdrawals for property purchases, so that the amount bears a reasonable relationship to the value of the property. This cap should initially be set at a generous level that will not unsettle or destabilise the property market, and then be gradually tightened. The Sub-Committee therefore proposes **to limit CPF withdrawals for housing to 150% of the value of the property**, at the time when the member applies to use his CPF funds. **We recommend to start with a 150% Valuation Limit this year, and bring it down to 120% in equal steps over 5 years.**

22. **The Valuation Limit should not apply to those who buy HDB flats on subsidised HDB mortgages**, so as to safeguard the basic objective of universal home ownership. It should also not apply to existing loans, because the mortgagors have already made long-term commitments under existing rules.

23. The impact of the Valuation Limit on the property market should be limited. The intention is for prospective homebuyers to take into consideration the revised limits when planning long-term commitments. Despite the Valuation Limit, they can still use their OA savings to pay for the full value of their homes. We estimate that 150% of valuation should be

sufficient for principal and interest repayments for the first 24 years of a 25-year loan. Even at 120% of valuation, a CPF member should be able to use CPF funds alone for up to 19 years in a 25-year loan, so that most home buyers will not be affected by this new Valuation Limit.

Enhancing Returns on CPF Balances

24. CPF members also need to invest for higher long-term returns so that they are better able to achieve the Minimum Sum upon retirement. Today, members can invest in unit trusts and investment-linked insurance products under the CPF Investment Scheme (CPFIS). But they face two main challenges in enhancing returns. First, investment costs are high because many of the unit trusts on the market are relatively small and cannot achieve economies of scale. Second, many members are unable to achieve balanced and diversified investment portfolios that can yield lower risks and higher returns over the long term.

25. Members can enjoy higher returns (even after making allowance for the risk involved) if they invest their funds on a long-term basis in well-diversified portfolios. In other countries such as the US, private sector pension providers offer pension plans that make and execute investment decisions on members' behalf, including decisions on strategic asset allocation. Large pension plans are also able to pass to their members some of the cost savings derived from pooling. Pension plan members can thereby enjoy lower institutional costs, instead of the higher retail costs involved if they invested in the market on their own.

26. The **Government should facilitate the provision of low-cost privately-managed pension plans to CPF members, as an additional option under the CPFIS framework**. Although current CPFIS rules do not explicitly prohibit such pension plans, they pose implicit impediments. For example, SA funds currently cannot be invested in equity funds, which are a key asset class in a diversified investment portfolio offered under most pension plans. Such rules will need to be reviewed. While members may be exposed to some market risk, well-diversified plans will carry less risk than investments in specific products. Members can also limit their downside risk by investing in plans with capital guarantee features.

27. Not every CPF member will be able or ready to participate in such pension plans. We therefore recommend that the CPF should continue the current arrangement of holding members' SA savings, unless they explicitly choose a pension plan or some other approved investment

product. We propose that the **interest rate paid on SA balances be pegged to a more appropriate long-term interest rate**, such as the yield on long-term government bonds. This is a more rational basis than the current system of pegging the SA interest rate to an arbitrary fixed premium over short-term rates (i.e. Ordinary Account rate + 1.5%-points).

Maintaining Stability of CPF Contribution Rates

28. Given its objectives of ensuring adequacy for retirement income, healthcare, and home ownership, the CPF system should have a long-term orientation. The Sub-Committee is of the view that we should **avoid using the CPF as a counter-cyclical, cost-cutting tool**, except as a last resort in exceptional economic circumstances. However, should it ever become necessary to reduce CPF rates, this should not be done at the expense of SA contributions. We should instead accelerate ongoing efforts to enhance the flexibility of the wage system.

II ENHANCING LABOUR MARKET FLEXIBILITY

Reducing Mandatory Contributions for High Income Earners

29. Based on December 2001 CPF data, the current monthly salary ceiling for CPF contribution of \$6,000 covers 92% of active CPF members. A monthly salary ceiling of \$4,000 would cover about 82% of active CPF members. In line with our proposal to peg the top contribution at no more than the 80th percentile income level, we should lower the current monthly salary ceiling for CPF contributions.

30. However, a one-step reduction from \$6,000 to \$4,000 would be too drastic. We therefore propose to **lower the CPF salary ceiling for both employer and employee contributions from the current \$6,000 to \$5,000**. Over 5 to 6 years, with wage growth and inflation, the 80th percentile income level should reach \$5,000.

31. **The purpose of this measure is not to cut wages or costs, but rather to enhance wage flexibility by reducing high statutory contributions.** We therefore propose that Government **phase in the lowering of salary ceilings together with the CPF restoration to 40%**. This will give CPF members and the labour market adequate time to adjust. We encourage employers to make appropriate adjustments to

salary packages of employees, so as to offset the CPF reduction and to reflect the employees' market value.

Giving Low Income Earners More Take-Home Pay

32. High contributions to the CPF for lower-wage workers also cause rigidities and distortions to the labour market, discouraging these workers from seeking work. Currently, employees do not contribute to CPF for wages up to \$200. Employee CPF contribution rates are phased in on a sliding scale from 5% for wages at \$200 to the full rate of 20% for wages at \$363 and above.

33. We propose to **raise these employee CPF wage bands from \$200-\$363 to \$500-\$750**. This will increase the take-home pay for low-wage and part-time workers, helping them to meet their current needs, and encouraging more to enter the workforce, even if on a part-time basis. **We recommend that this measure be implemented immediately**. Employer CPF contributions should continue to be paid on wages \$50 and above.

Enhancing Wage Flexibility and Employability for Workers Aged 50-55

34. In an increasingly competitive and uncertain business environment, the creation and retention of jobs remains a key priority. This will require greater flexibility in wages, a willingness to accept new jobs, and more frequent upgrading of skills across the workforce.

35. The past two recessions have shown that older workers, once retrenched, face more difficulty in securing re-employment compared to their younger counterparts. While a mismatch in skills is a key challenge to overcome for older workers, skills upgrading alone may not be sufficient.

36. **We have to move away from a seniority-based wage system, which is more pronounced in Singapore than in other countries, so that wages are more closely tied to skills and productivity**. However, this process will take time and may not be sufficient, because of institutional and labour market rigidities. We must therefore also adjust the statutory CPF component of the wage structure to help mitigate the seniority bias in our current wage structure.

37. Workers above 50 will be the most vulnerable to competitive pressures. They are less well educated than younger workers, less readily retrained and less easily redeployed into new jobs. CPF contribution rates for those above 55 are already much lower than for the rest of the workforce. We have to make similar, but more modest, adjustments for those in the 50-55 age group², so as to achieve greater wage flexibility and help preserve jobs for these workers. We propose that the Government **keep the employer CPF contribution rate for those in the 50-55 age group at its present level of 16%, even as the rate is restored to 20%** for those below 50.

38. We also propose that the Government **lower the employee CPF contribution rate for those in the 50-55 age group from the present level of 20% to 16%**. This should be **phased in together with the restoration of the CPF rate to 40% for the rest of the workforce**. This will help mitigate a reduction in take-home pay for older workers seeking re-employment in lower-wage jobs.

39. The effect will be a meaningful reduction in total CPF contribution rate, from 40% (20 + 20) for those below 50, to 32% (16 + 16) for those aged 50-55, to 20% (7.5 + 12.5) for those aged 55-61, after restoration to 40%. This will make it easier for the 50-55 age group to remain employed.

40. **Employers are encouraged to pass on part of their cost savings to deserving workers in this age group as the CPF is restored for the others. Employers can do so through the variable component of their wages, e.g. bonuses or the monthly variable component (MVC), depending on the circumstances of each company and the contribution of each worker.**

41. Some workers in the 50-55 age group may face mortgage payment shortfalls, especially when the SA and MA rates are increased by a further 3%-points and 1-% point respectively to reach their target levels. When the Government reduced the employer CPF contribution rate in 1999, a set of measures, including allowing the use of SA balances, was implemented to assist members with mortgage shortfalls. The intention was to phase out these measures when the CPF rate is fully restored to 40%. To help affected members adjust, **the Government should allow workers aged 50-55 to continue to draw on their SA for a period of time, to meet any shortfalls in their mortgage repayments due to the non-restoration of employer CPF rate.**

² 50-55 refers to those who are aged between 50 years and 1 day and 55 years exactly

42. These proposed recommendations to enhance the flexibility of the wage structure for workers in the 50-55 age group can only be part of a larger programme of measures aimed at strengthening the long-term employability of these workers. The non-restoration of the employer CPF rate for this group signals the need to address this long-term issue and must be complemented by other sustained efforts, especially in skills upgrading and re-training.

CONCLUSION

43. Singapore faces significant economic challenges in the years ahead. We are also a rapidly ageing society. We need to refocus the CPF towards enhancing Singaporeans' financial security in retirement. This means we must safeguard a larger proportion of funds in the CPF for retirement needs, place judicious limits on withdrawals for housing, and introduce enhanced investment options to improve risk-adjusted returns for members.

44. At the same time, the CPF system must support a more flexible labour market, so as to preserve jobs and maximise employment. Taken in totality, **our recommendations seek to strike a balance between the competing priorities of enhancing retirement security, providing for home ownership, and increasing economic flexibility.**

SUMMARY OF KEY RECOMMENDATIONS

| S/No | Recommendations | Objectives |
|--|--|---|
| Safeguarding CPF Funds for Retirement | | |
| 1. | Increase the contribution rate to the Special Account by an additional 1%-point to 5/7/9 (5% for members 35 years and below, 7% for members above 35 to 45 years, and 9% for members above 45 to 55 years) as we restore the CPF contribution rate to 40%. | <ul style="list-style-type: none"> • Boost members' Special Account balances and help them reach the Minimum Sum |
| 2. | Limit CPF withdrawals for housing to 150% of the value of the property starting this year, and to bring this Valuation Limit down to 120% over 5 years. This cap should not apply to subsidised loans for HDB flats, nor to all existing loans. | <ul style="list-style-type: none"> • Safeguard funds withdrawn for housing purposes |
| 3. | Increase Minimum Sum gradually as wages rise over time. | <ul style="list-style-type: none"> • To meet higher standards of living and rising expectations of basic retirement needs for future generation of retirees |
| 4. | Explore ways to help homeowners monetise their housing assets. | <ul style="list-style-type: none"> • Give Singaporeans greater flexibility to convert their housing assets into retirement income • Enhance adequacy for retirement |
| 5. | Use the CPF as a counter-cyclical, cost-cutting tool only as a last resort. | <ul style="list-style-type: none"> • Reaffirm long-term orientation of CPF system in providing for Singaporeans retirement needs |

| S/No | Recommendations | Objectives |
|---|---|--|
| Addressing Healthcare Needs | | |
| 6. | Reaffirm Government's intention to increase the contribution rate to the Medisave Account (MA) by 1% point to 7/8/9 (7% for members 35 years and below, 8% for members above 35 to 45 years, and 9% for members above 45 years) when we restore the CPF contribution rate to 40%. | <ul style="list-style-type: none"> • To address upward pressures on healthcare costs and rising expectations of Singaporeans in healthcare • To help Singaporeans better prepare for their healthcare needs in retirement |
| 7. | <p>Increase risk-pooling via enhanced medical insurance, while retaining the framework of co-payments and deductibles.</p> <p>Explore devolving the health insurance system and other CPF-based insurance schemes to private insurers to operate and manage.</p> | <ul style="list-style-type: none"> • Improve the efficiency of financing healthcare expenses. • To provide enhanced insurance coverage for Singaporeans • Improve competition, thereby boosting provider quality and keeping premiums under market discipline |
| Enhanced Investment Choices For Improved Returns | | |
| 8. | Facilitate the provision of low-cost privately-managed pension plans to CPF members, as an additional option under the CPFIS framework. | <ul style="list-style-type: none"> • Achieve economies of scale for investment of retirement funds and reduce investment costs. • Increase returns on members' CPF balances |

| S/No | Recommendations | Objectives |
|--|--|---|
| 9. | Peg the interest rate paid on SA balances to an appropriate long-term interest rate, such as the yield on long-term government bonds. | <ul style="list-style-type: none"> • Rationalise the existing system of pegging the SA interest rate to an arbitrary fixed premium over short-term rates |
| Enhancing Labour Market Flexibility | | |
| 10. | <p>Lower CPF salary ceiling from \$6,000 to \$5,000, to be phased in as we restore the CPF contribution rate to 40%.</p> <p>Encourage employers to make appropriate adjustments to salary packages to offset the CPF reduction and to reflect the employees' market value.</p> | <ul style="list-style-type: none"> • Reduce mandatory savings for members with incomes above the 80% income percentile level • Give these members greater autonomy and flexibility to deploy their income |
| 11. | Raise the employee CPF wage bands for lower-income workers from \$200 - \$363 to \$500 - \$750. | <ul style="list-style-type: none"> • Increase take-home pay of low-wage workers • Encourage part-time work, increase labour force participation |

| S/No | Recommendations | Objectives |
|------|--|--|
| 12. | <p>Keep the employer's CPF contribution rate for workers in the 50-55 age group at its present level of 16%, even as the rate is restored to 20% for the other age groups.</p> <p>Lower the employee's CPF contribution rate for employees in the 50-55 age group from the present level of 20% to 16%, as we restore the CPF contribution rate for the other age groups.</p> <p>Allow members aged 50-55 to continue using their Special Account to meet shortfalls in mortgage repayments for a longer transition period.</p> <p>Encourage employers to pass on part of their cost savings to deserving workers in this age group through the variable component of their wages, depending on the circumstances of each company and the contribution of each worker.</p> | <ul style="list-style-type: none"> • Move from seniority-based wage system towards a more flexible wage system • Enhance employability of workers in the 50-55 age group • Help members affected by the non-restoration in employer's CPF contribution rate to overcome mortgage shortfalls |

CHAPTER 1: RECENT DEVELOPMENTS AND FUTURE CHALLENGES

Recent Developments

1. Since its introduction in 1955, the Central Provident Fund (CPF) system has provided Singaporeans with a structured framework to save for their own retirement. From its origins as a pure retirement savings scheme, the role of CPF has grown over the years. Today it addresses both retirement expenditure and healthcare needs, and has also enabled the vast majority of Singaporeans to purchase their own homes. A comprehensive listing of major CPF schemes is at **Annex A**.
2. The CPF has undergone several adjustments in recent years. In 1999, as part of the cost cutting package of measures to cushion the impact of the Asian financial crisis on businesses and preserve jobs, the employer's CPF contribution rate was reduced by 10 percentage (%) points, from 20% to 10%, while the employee's share of contribution remained at 20%.³
3. Within the CPF accounts, the Special Account (SA) contribution rate has been subject to significant fluctuation. It was cut to 0% during each of the CPF cuts in 1986 and 1999.
4. The reduction of employer's CPF contribution rate to 10% was a temporary measure to deal with an immediate crisis. It was gradually restored over the past 2 years, by 2%-points in Apr 2000 and an additional 4%-points in Jan 2001, to the current 16% rate. Government has committed to restore the employer CPF contribution to the original rate of 20% as soon as possible, at a pace that the economy can bear.
5. In November 1999, the Inter-Ministerial Committee for the Ageing Population (IMCAP) released its recommendations for a co-ordinated national approach to deal with the challenges posed by Singapore's ageing population. One of its areas of concern was the financial security of Singaporeans during old age. To enable CPF members to build up more cash savings for old age, IMCAP recommended that the CPF contribution rates for the SA be stepped up with age as follows:

³ Similarly, during an earlier recession in 1986, the Government reduced the employer CPF contribution rate from 25% to 10%. It was only in 1994 that the rate was restored to 20%.

| Age (Years) | Contribution Rate (%) |
|--------------------|------------------------------|
| 35 and below | 4 |
| > 35 to 45 | 6 |
| > 45 to 55 | 8 |
| > 55 | 0 |

6. This recommendation was accepted by the Government and implemented partially with the second CPF restoration in January 2001. The current Special Account contribution rate is 4/6/6 (in % terms for members 35 years and below, members between 35 and 45, and members between 45 and 55 respectively).

7. At the same time, to keep pace with the cost of medical care and rising expectations of patients, the Government also decided to increase the Medisave Account (MA) contribution rate by 1% point across the various age groups to between 7 and 9% as follows:

| Age (Years) | Contribution Rate (%) |
|--------------------|------------------------------|
| 35 and below | 7 |
| > 35 to 45 | 8 |
| > 45 | 9 |

8. The adjustment in the MA contribution rate is to be effected when the CPF contribution rate is restored to 40%. The Government announced that priority for the build-up of the accounts to their target rates would be given first to the SA, then the OA, and finally the MA.

Enhancing Financial Security in Retirement

9. Going forward, the CPF system faces some challenges. Many CPF members today are “asset-rich and cash-poor” at retirement. This imbalance arises mainly because of large withdrawals of CPF funds for property purchases. It is estimated that approximately half of members’ CPF balances today (excluding Medisave), go toward property purchases.

10. It is rational and sensible for Singaporeans to invest in property. Not only does this provide their families with a roof over their heads, it also gives them a substantial asset that offers added financial security in retirement. From a national perspective, home ownership has helped to give citizens a greater stake in Singapore’s success and build stronger

communities. CPF members should not be deterred from investing in housing for their retirement, as long as they do so prudently.

11. However, as our society ages, Singaporeans will need greater flexibility to convert the homes they own into income to help meet retirement needs. Today, there are several options for homeowners to monetise their housing assets, but there are structural and social impediments to them doing so.

- a. **Reverse mortgages** - These are not commercially viable under current rules. First, reverse mortgages are not allowed for HDB flats. Second, even if HDB allowed reverse mortgages, the current lease term of 99-years on HDB flats is a disincentive for commercial providers of such mortgages to enter the market. A CPF member who buys his flat in his 20s and retires at 62 would have used 40 years of the lease. There would be limited upside for the property during the remainder of the lease.
- b. **Subletting** – Currently, subletting of rooms is allowed for HDB flats. However, the subletting of an entire flat is currently only allowed on a case-by-case basis, for retirees above 65 living in three-room flats, and for other lessees in exceptional circumstances.⁴
- c. **Downgrading** – This would enable Singaporeans to unlock part of the value of their owner-occupied properties. But the scope for doing so is limited given that two out of every three elderly households today live in 3-room or smaller flats and have no smaller accommodation to downgrade to. Another possibility is for the elderly to sell their flats and live in rental HDB flats. Such downgrading would, however, require a significant behavioural change from today, as only 3.6% of elderly living in HDB flats have downgraded to smaller flats.

The Sub-Committee recommends that the Government explore various means to make it easier for homeowners to monetise their property. The Land Working Group of the Sub-Committee is deliberating and following-up on these issues.

12. However, the Sub-Committee recognises that even if the mechanisms are available, not all Singaporeans will be in a position to

⁴ E.g. lessees who go overseas to work or study.

monetise their property. There will be a certain proportion of retirees who will choose to retain and live in their current home after retirement for various reasons. We therefore need additional measures to help members increase their CPF cash balances and reach the Minimum Sum.

13. A second factor that would necessitate increased reliance on CPF savings in the years ahead is demographic in nature. Today, most retirees are still able to look to their children for additional support. However, changes in social and demographic trends in Singapore mean that future retirees will not be able to rely on their children to the same extent as today's retirees. With longer life expectancies, families with fewer children and a growing proportion of never-married retirees, future generations will have to depend more on their own CPF savings for financial security in retirement.⁵

14. The CPF system has served Singaporeans well. But going forward, we face challenges in ensuring adequacy for future retirees. We need to take proactive steps to refocus the CPF system to enhance the financial security of Singaporeans in retirement.

⁵ The proportion of elderly singles in the population aged above 65 is expected to increase from 2.4% in 2000 to 7.8% in 2020, dependency ratios are projected to deteriorate from 1 retiree for 10 working adults in 2000 to 1 retiree for 3 working adults in 2030. Life expectancy is also expected to rise from 78.0 in 2000 to 79.9 in 2030.

CHAPTER 2: KEY PRINCIPLES FOR A REFOCUSSED CPF SYSTEM

15. The CPF system is fundamentally sound. It emphasises personal responsibility for retirement. Each member's retirement benefits are self-funded from the contributions he has made over his working life. This is a more sustainable system than the pay-as-you-go pension systems prevalent in many developed countries where retirees' benefits are funded by the current working population. We **reaffirm the principle of self-reliance as an essential tenet underpinning the CPF system**. In reviewing and making recommendations for refocusing the CPF system, the Sub-Committee has adopted four guiding principles.

16. First, the CPF should continue to **cater to the three key needs of retirement expenditure, healthcare and home ownership**. These three key needs constitute the basis of financial security in retirement. The CPF cannot be expected to meet the broader financial needs of its members. A scheme that is too diffuse in its focus may mean that the key retirement needs cannot be adequately met.

17. Second, the CPF should **meet the key needs at a basic level**. The CPF should be able to support a retirement lifestyle that is adequate but not lavish. Requirements beyond the basic level should be met from individuals' private savings and should not be catered for within the CPF system. To do so would necessitate a further rise in CPF contribution rates. This is not desirable because CPF is already a substantial part of a worker's income. Higher contribution rates will constrain members' ability to meet current consumption needs as well as reduce labour market flexibility.

18. Third, the CPF should **focus primarily on the broad majority of Singaporeans**, between the 10th and 80th percentiles of the income spectrum. Due to the significant difference in retirement needs of Singaporeans across the income spectrum, a one-size-fits-all structure would not be feasible. Hence, the CPF should focus primarily on the broad majority of the income spectrum. Given that CPF forms a large statutory component of wages, it should be scaled back where it is not necessary or where it does not meet its intended objectives.

19. The lowest income group (10th percentile and below) cannot rely on CPF alone for their retirement needs. To do so would require higher levels of CPF contributions which would leave them with too little take-home pay for their current consumption needs. The Government has been offering

schemes such as subsidised HDB rentals, Medifund and public assistance to help the lowest income group, and these social support schemes and policies should continue to supplement the CPF framework.

20. At the top end, for households with incomes above the 80th percentile, there is no need to impose on them the same level of mandatory savings as for the rest of the population. Those in this group have a greater ability to look after their own financial affairs, and should be encouraged to take greater responsibility for their own financial planning, including planning for their retirement needs.

21. Fourth, **changes to the CPF system must be made gradually.** CPF members have made long-term decisions based on the current framework, and must be given time to adjust to any policy changes. Our approach in this current review is to mark out the broad path that the CPF should take in the future and allow these changes to set in steadily, rather than to introduce drastic changes that could shock and destabilise the system.

22. The implementation of many of our recommendations is linked to the restoration of the CPF contribution rate to 40%. When and how quickly this is achieved is beyond the remit of the Sub-Committee. However, we envisage it taking place over the next 2-4 years, depending on the state of the economy. There should thus be ample time for the system to adjust, and for Singaporeans to adapt to the changes being proposed.

CHAPTER 3: RETIREMENT ADEQUACY

CPF Minimum Sum Scheme

23. The Government introduced the Minimum Sum Scheme in 1987, to ensure that CPF members set aside a minimum level of savings for retirement. The Minimum Sum is the basic nest egg that Singaporeans should have when they retire, and it would be sufficient to enable retirees to meet a very basic level of retirement expenditure. CPF members were allowed to withdraw their CPF savings at 55 years of age only upon setting aside the Minimum Sum. The Minimum Sum was then set at \$30,000 and could be entirely in the form of a property pledge.

24. To cater for rising standards of living, the Minimum Sum was revised in 1995 to progressively increase to \$80,000 by 2003 (at \$5,000 annually from 1995 to 2003), of which at least \$40,000 had to be in cash. The Government also announced that once the \$80,000 is reached in 2003, it would increase by inflation thereafter.

Setting Aside More in the Special Account

25. The Government has committed to restore the CPF contribution rate to 40% from the current 36% as soon as economic conditions allow. It has also committed to increase the Special Account (SA) contribution rates from the current 4/6/6 (4% for members 35 years and below, 6% for members above 35-45 years, and 6% for members above 45-55 years respectively), to 4/6/8 as the total CPF is restored to 40%.

26. However, the SA rates need to be increased beyond 4/6/8 in order to meet future retirement needs. Even at 4/6/8, many members will have difficulty meeting the Minimum Sum, which will be \$80,000 from July 2003. At SA contribution rates of 4/6/8, the Sub-Committee projects that only about 50% of new members with a full career of contributions to the CPF would reach at least \$80,000 in cash by 55, or \$40,000 after half the cash is withdrawn.

27. To boost their SA savings and help members reach the Minimum Sum, we propose to **increase the contribution rate to the Special Account by an additional 1%-point as we restore the CPF contribution rate**, as shown in the table overleaf. This will increase members' SA

balances by about 20%, and enable an additional 10% of all members to reach the Minimum Sum by 55.

Table 1: Special Account Contribution Rates

| Age of Member | Current Rate (%) | Announced Rate upon CPF Restoration (%) | Recommended Rate upon CPF Restoration (%) |
|-----------------------------|------------------|---|---|
| 35 years and below | 4 | 4 | 5 |
| Above 35 and up to 45 years | 6 | 6 | 7 |
| Above 45 and up to 55 years | 6 | 8 | 9 |

Increasing the Minimum Sum to Cater for Higher Living Standards

28. The CPF Minimum Sum cannot remain static. The Minimum Sum will be raised to \$80,000 on 1 July 2003, of which \$40,000 can be in property. The Government had previously projected that the current Minimum Sum of \$80,000 will provide an annuity of \$450 per month, after adjusting for inflation. As the economy grows and wages rise, successive cohorts of Singaporeans will have higher expectations of what they consider to be a basic level of needs in retirement. Over time, an annuity income of \$450 based on the existing Minimum Sum of \$80,000 will become insufficient for the majority of retirees.

29. We recommend that **as wages rise over time, the Minimum Sum should also be increased in step, beyond the \$80,000 that will take effect on 1 Jul 2003.** This will have to be phased in gradually, as many members do not have sufficient CPF balances to meet even the existing Minimum Sum today.

Maintaining Stability of CPF Contribution Rates

30. Given its objectives of ensuring adequacy for retirement income, healthcare, and home ownership, the CPF system should have a long-term orientation. The Sub-Committee is of the view that we should avoid using the CPF as a counter-cyclical, cost-cutting tool, except as a last resort in exceptional economic circumstances. However, should it ever become necessary to reduce CPF rates, it should not be done at the expense of SA contributions. We should instead accelerate ongoing efforts to enhance the flexibility of the wage system.

CHAPTER 4: HEALTHCARE ADEQUACY

Introduction

31. To help Singaporeans take responsibility for their own healthcare needs, the Government introduced the Medisave Scheme in 1984. Under this scheme, working Singaporeans are required to set aside 6-8% of their income, depending on age, into a personal Medisave Account (MA) from which they may withdraw to pay the hospitalisation expenses incurred by themselves or their families. Government has announced that the MA contribution rates will be raised by 1%-point to 7-9% to keep pace with higher patient expectations and cost of medical services.

32. The fundamental principle of our healthcare financing system is individual savings, with Government subsidies and insurance playing supplementary roles. As such, it is important that Singaporeans are able to build up sufficient Medisave balances to meet their hospitalisation expenses, the bulk of which are likely to be required during old age. Their Medisave balances should be sufficient to pay for the cost of medical treatment at Class B2 level and the premiums of MediShield Basic.

Current Situation

33. Since the inception of Medisave, its usage has become increasingly widespread. Besides inpatient expenses, the Government has allowed Medisave to be used for certain expensive outpatient treatments such as radiotherapy and chemotherapy. Medisave has been liberalised to cover selected types of step-down care such as community hospitals and hospices, which has helped alleviate the financial burden on elderly patients. Medisave can also be used to pay for the premiums of MediShield or Medisave-approved insurance schemes, and ElderShield.

34. The availability of Medisave has led to less restraint by Singaporeans in choosing the level of healthcare services that they really require. As such, only 56% of CPF members who reached age 55 in 2000 were able to meet the prevailing Medisave Minimum Sum of \$19,000. The Medisave balances of Singaporeans who turned 55 in 2000, at about \$16,000⁶, were not high given that the Medisave Minimum Sum will increase to \$25,000 in 2003.

⁶ The figures quoted for Singaporeans at age 55 apply to employees only and exclude pensioners and self-employed persons.

35. At the same time, Singapore is facing strong upward pressures on healthcare costs. This is a phenomenon in many developed countries and Singapore is not immune to this trend. Advances in medical technology and new developments in diagnostics, biomedical devices and drug development, tend to drive up the cost of healthcare services.

36. Furthermore, as our standard of living improves, Singaporeans will have higher expectations. Demand for healthcare services will correspondingly increase. In particular, we are undergoing a major structural change in our demographics with an aging population. The Medisave scheme will come under increasing strain as Singaporeans increase their reliance on Medisave savings to meet the rising cost of healthcare.

Strengthening Provisions for Healthcare Needs

37. To help Singaporeans better prepare for their healthcare needs in retirement, the Sub-Committee supports Government’s intention to **increase the contribution rate to the Medisave Account by 1%-point as we restore the CPF contribution rate**, as follows.

Table 2: Medical Account Contribution Rates

| Age of Member | Current Rate (%) | Recommended Rate upon CPF restoration (%) |
|-----------------------------|------------------|---|
| 35 years and below | 6 | 7 |
| Above 35 and up to 45 years | 7 | 8 |
| Above 45 year | 8 | 9 |

38. We also support the Government’s intention to **move towards greater risk pooling through insurance to complement Medisave** and improve the efficiency of financing healthcare expenses. Greater risk pooling through MediShield will improve insurance coverage for Singaporeans. The current framework of co-payments and deductibles should also be retained so as to avoid over-consumption of healthcare and reinforce personal responsibility for healthcare.

39. There is a need to review the overall structure of healthcare insurance system in Singapore to maximise system efficiencies. International experience in Germany, Switzerland and the Netherlands suggests that there is no reason why private companies cannot do the same job as Government, provided appropriate regulations are in place to

protect individuals and insurers alike. In fact, competition could be used as a key policy lever to reduce premium growth and drive provider quality through active purchasing by the insurers.

40. Therefore, to generate healthy competition in the health insurance market, the Sub-Committee recommends that **Government consider devolving MediShield to private insurers to operate and manage.** This would be similar to the way in which Government has allowed insurers to operate ElderShield. Government would need to put in place an appropriate regulatory framework to ensure that over-pricing and discriminatory behaviour do not nullify the potential competitive efficiencies. If such a private insurance model is found to be workable, the Government could **consider extending this to other CPF-based insurance schemes, such as the Home Protection Scheme and Dependants' Protection Scheme.**

CHAPTER 5: HOME OWNERSHIP

Encouraging Prudent Withdrawals for Housing

41. The Ordinary Account (OA) should allow members to own a home commensurate with their income and provide additional savings to supplement the retirement income provided by the SA. As housing absorbs a large part of the OA savings of many members, we need **to ensure that withdrawals for housing are not excessive in relation to the property value**

42. When the Residential Properties Scheme for purchases of private property was introduced in 1981, withdrawals of CPF savings were limited to 80% of the initial purchase price of the property. The rationale was to provide a 20% safety margin on CPF monies withdrawn, and protect members against any drastic fall in property prices. This was also in line with the practices of financial institutions in assessing housing loans. However this withdrawal limit was liberalised over the years. (See **Annex B** for details).

43. Presently, for HDB resale flats and private properties, a Valuation Limit (VL) and Available Housing Withdrawal Limit (AHWL) are applied. The VL is the market value of the property at the time of purchase or the purchase price, whichever is lower. If the housing loan is still outstanding when the total CPF withdrawals reach the VL, CPF members can use additional CPF savings up to the AHWL⁷. The AHWL is a moving limit. As long as the members continue to make contributions to their CPF accounts after reaching the VL, they will be able to withdraw additional CPF funds to service their mortgage loans.

44. As a result, homebuyers are effectively allowed to withdraw from their OA funds an amount much more than 100% of the value of the property, to pay for both the principal and interest on their mortgages. As an illustration, total OA withdrawals by a homebuyer could reach 160% of the initial purchase price by the end of a 25-year loan. While the use of CPF for the repayment of principal can be considered as investment in housing equity, use of CPF to service mortgage interest is essentially consumption. This consumption is at the expense of retirement adequacy and should be controlled.

⁷ The AHWL is set as the lower of:

- 80% of the gross CPF savings in excess of the Minimum Sum; or
- the available ordinary account balance after setting aside the Minimum Sum cash component

45. Based on current rules, the value of a property would have to appreciate steadily by 3.5% per annum to keep pace with the mounting CPF funds committed to its mortgage. Whilst it is reasonable to expect long-term property appreciation with economic growth, the property market goes through pronounced cycles. Property-buyers in the boom period of 1995-97 are now in a negative equity position. Unless CPF withdrawals are appropriately capped, CPF savings committed to housing will be vulnerable to fluctuations in property values and will in effect be consumed by the member.

46. We propose to cap OA withdrawals for property purchases, so that the amount withdrawn bears a reasonable relationship to the value of the property. This cap should initially be set at a generous level that will not unsettle or destabilise the property market, and then gradually tightened. The Sub-Committee therefore proposes **to limit CPF withdrawals for housing to 150% of the value of the property at the time when the member applies to use his CPF funds**. We recommend to start with a 150% Valuation Limit this year, and to bring it down gradually to 120% in equal steps over 5 years.

47. **The Valuation Limit should not apply to those who buy HDB flats on subsidised HDB mortgages**, so as to safeguard the basic objective of universal home ownership. It should also not apply to existing loans, because the mortgagors have already made long-term commitments under existing rules. It will only apply to new private property and market rate HDB loans.

48. The impact of the new Valuation Limit on the property market should be limited. The intention is for prospective homebuyers to take into consideration the revised limits when planning long-term commitments. Despite the Valuation Limit, they can still use their OA savings to pay for the full value of their homes. We estimate that 150% of valuation should allow CPF funds to be used for principal and interest repayments for the first 24 years in a 25-year loan. Even at 120% of valuation, the CPF member should be able to use CPF funds alone for up to 19 years in a 25-year loan, so that most homebuyers will not be affected by this new Valuation Limit.

49. Currently, housing withdrawals exceed 120% of valuation for only a minority of CPF members. In addition, feedback from selected major banks on the proposed limits indicates that caps of between 110% to 130% were reasonable and not likely to be constraining.

CHAPTER 6: ENHANCING RETURNS ON CPF BALANCES

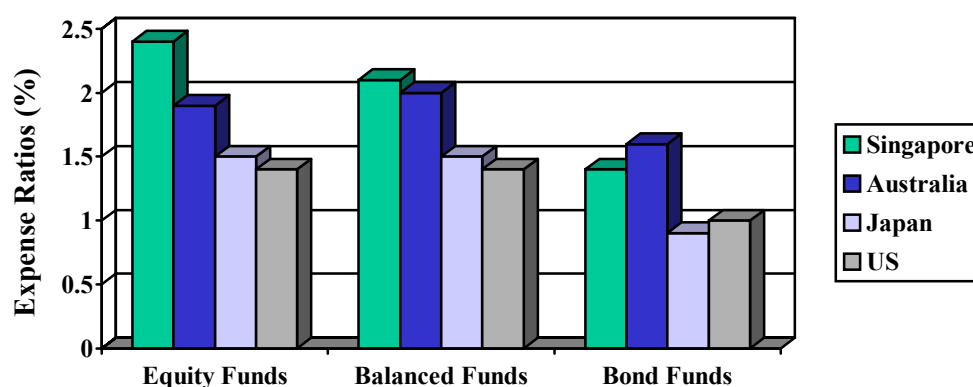
Enhancing Returns on CPF Balances

50. The current rates of return on CPF balances are not adequate for retirement funds with a long investment horizon. Several studies have found that the returns from CPF balances, while less volatile, are significantly lower than pension fund returns in most countries⁸.

51. CPF members need to invest for higher long-term returns so that they are better able to achieve the Minimum Sum upon retirement. Today, members can invest in a variety of collective investment schemes such as unit trusts and investment-linked insurance products under the CPF Investment Scheme (CPFIS). But they face several challenges in enhancing returns.

52. Investment costs to members are very high because many of the unit trusts on the market are small retail funds that cannot achieve economies of scale. According to a survey in 2001, 76% of the 156 CPFIS funds are below \$50m in fund size, and 34% below \$10m. The small fund sizes mean that expense ratios (investment expenses/asset value) are high. Cross-country comparisons (**Chart 1**, below) show that Singapore funds tend to incur higher expense ratios compared to international funds due to their small fund sizes.

Chart 1: Comparison of Expense Ratios



Source: Mercer

⁸ See for instance, Mukul Asher (1999), "The Future of Retirement Protection in Southeast Asia", *International Social Security Review*, Vol. 51, 1/98, and Roberto Cardarelli (2000), "Singapore's CPF: Options for a Comprehensive Reform", *Singapore: Selected Issues in IMF Staff Country Report No. 00/83*.

53. Aside from high expense ratios, the retail nature of unit trust products result in an additional layer of costs in the form of initial sales charges and agent bank fees. Under the existing cost structure of CPFIS unit trust investments, an estimated 41% of the terminal value of invested funds is eroded by various investment costs by the time of retirement. This estimate assumes no churn in a member's investment portfolio, and that the unit trusts are held till retirement. If members switch between unit trusts throughout their lifetimes, as is observed currently, the amount lost to investment costs will be even higher.

54. Because individual CPF members generally do not have access to professional portfolio management expertise or adequate investment information, they are unable to achieve balanced and diversified investment portfolios that can yield lower risks and higher returns over the long term.

55. Members can enjoy higher returns (even after making allowing for the risk involved) if they invest their funds on a long-term basis in well-diversified portfolios. In other countries such as the US, private sector pension providers offer pension plans that make and execute investment decisions on members' behalf, including decisions on strategic asset allocation. Large pension plans are able to pass to their members some of the benefits of cost savings derived from pooling retirement funds. Pension plan members can thereby enjoy lower institutional costs instead of the higher retail costs involved if they invested in the market on their own. In addition, pension plans have access to professional fund management expertise and are able to invest in globally-diversified portfolios on behalf of their members, generating higher risk-adjusted returns in the long-term._

56. **The Government should facilitate the provision of low-cost privately-managed pension plans to CPF members, as an additional option under the CPFIS framework.** Although current CPFIS rules do not explicitly prohibit such pension plans, they pose implicit impediments. For example, Special Account funds currently cannot be invested in equity funds, which are a key asset class in a diversified investment portfolio offered under most pension plans. Furthermore, all collective investment schemes must be offered in S\$ rather than the providers' own currency, which limits the scope for foreign pension plan providers. Such rules will need to be reviewed. While members may be exposed to some market risk, well-diversified plans will carry less risk than investments in specific products. Members can also limit their downside risk by investing in plans with capital-guarantee features.

57. Not every CPF member will be able or ready to decide whether or not to participate in such pension plans, however simply these plans are designed. We therefore recommend that the CPF should continue the current arrangement of holding members' Special Account savings, unless they explicitly choose a pension plan or some other approved investment. We recommend that **the interest rate paid on SA balances be pegged to a more appropriate long-term interest rate**, such as the yield on long-term government bonds. This is a more rational basis than the current system of pegging the SA interest rate to an arbitrary fixed premium over short-term rates (i.e. OA + 1.5%-points).

CHAPTER 7: ENHANCING LABOUR MARKET FLEXIBILITY

Reducing Mandatory Contributions for High-Income Earners

58. Based on December 2001 CPF data, the current monthly salary ceiling of \$6,000 (for both the employer and employee) covers 92% of active CPF members. In line with the principle of refocusing CPF to meet the needs of the broad majority of Singaporeans, i.e. between the 10th and 80th percentile, there is no reason to impose high levels of mandatory saving for individuals with incomes above the 80th percentile.

59. This group of high-income earners should have the wherewithal to plan for and look after their own retirement needs, relying more on their voluntary savings. We should reduce the level of statutory contributions and give them greater autonomy and flexibility to deploy their income. We should therefore lower the monthly salary ceiling for CPF contributions.

60. Based on December 2001 CPF data, a \$4,000 salary ceiling would cover about 82% of active CPF members. However, a one-step reduction in the salary ceiling from \$6,000 to \$4,000 would be too drastic. We therefore propose to **lower the CPF salary ceiling for both employer and employee contributions from \$6,000 to \$5,000**, which would still cover 88% of active CPF members. With wage growth and inflation, a monthly salary of \$5,000 will naturally gravitate toward the 80th percentile income level over 5 – 6 years.

61. **The purpose of this measure is not to cut wages or costs but rather to enhance wage flexibility by reducing high statutory contributions.** To give CPF members as well as the labour market adequate time to adjust, we propose that the Government **phase in the lowering of salary ceilings together with the CPF restoration to 40%.**

62. **We encourage employers to make appropriate adjustments to salary packages of employees so as to offset the CPF reduction and to reflect the employees' market value.** Since CPF contributions are tax-deductible, employees who wish to enjoy a similar tax position compared to before the lowering of the salary ceiling can channel more of their voluntary savings into the Supplementary Retirement Scheme.

Giving Low-Income Workers More Take-Home Pay

63. Currently, employers contribute the full rate of CPF on salary above \$50 per month. Employees do not contribute to CPF for wages below \$200. Employee CPF contribution rates are then phased in on a sliding scale from 5% for wages at \$200 to the full rate of 20% for wages at \$363 and above. These limits were set many years ago.

64. The principles underlying the existence of wage floors for employer and employee contributions differ. Employers' contributions constitute part of the total wage package for workers. A higher wage floor for employers' contributions would mean that lower income workers receive lower wages. Hence, the objective would be set as low a wage floor for employers' contributions as feasible to protect these workers

65. In contrast, a low wage floor for employee's contribution would reduce their take home pay. For the lower income members, a higher wage floor for employees' contribution would be desirable.

66. The current employer's salary floor for CPF contribution of \$50 should be retained so as to provide most of the lowest income workers with some CPF savings for retirement. We should, however, raise the threshold salaries at which the employee's contribution is phased-in. The Sub-Committee proposes to **raise the employee CPF wage bands from \$200 - \$363 to \$500 - \$750**. This will effectively increase the take-home pay for all workers earning \$750 and below. It will also help encourage more workers to enter the workforce, even if it is on a part-time basis. **We recommend that this measure be implemented immediately**. Employer CPF contributions should continue to be paid on wages \$50 and above.

Enhancing Wage Flexibility and Employability for Workers Aged 50-55

67. In an increasingly competitive and uncertain business environment, the creation and retention of jobs remains a key priority. This will require greater flexibility in wages, increased willingness to accept new jobs and more frequent upgrading of skills across the workforce.

68. The experiences of the last two recessions have shown that our older workers, once retrenched, face more difficulty in securing re-employment compared to their younger counterparts. The re-employment rate for those aged 50 and above⁹ was 37% compared to the rate of 56%

⁹ Source : Labour Market Survey, First Quarter 2002.

for the 30 year-old younger cohort. For unemployed older worker who found another job, it also took them longer on average to obtain re-employment. The median duration of unemployment for workers aged 40 and above was 14.2 weeks. For those aged 50 and above, it was 21 weeks. These compare unfavourably to the 11.5 weeks for younger workers below 40. With continued economic structuring, we can expect this trend to worsen.

69. There are a number of reasons for this trend. First, older workers have to overcome a skills mismatch. Second, the prevailing seniority-based wage system is more pronounced in Singapore than in other countries. Coupled with large statutory contributions under the CPF system, employers find it more costly to employ older workers. This puts older workers at greater risk when companies are forced to downsize. A holistic approach to tackle the employability problems of older workers is needed by focusing on both skills upgrading as well as removing rigidities in the wage structure. This would ensure that wages are more closely tied to productivity, thereby enhancing flexibility as well as preserving jobs.

Upgrading Skills

70. Government introduced the "People for Jobs Traineeship Programme" (PJTP) in Jun 2001, which aims at helping older job seekers (aged 40 years and above) who are prepared to make a career switch across sectors. The programme encourages companies to put in place traineeship arrangements to better induct and increase the comfort level of older workers taking on a new job in a new working environment, thereby shortening the average time for the older worker to pick up new skills and start contributing to the company.

71. The programme was conceived for a 6-month pilot run from June to November 2001. Due to worsening labour market conditions, the programme was extended for another year from 1 November 2001. At the same time, financial support for the programme was increased to the lower of 50% of gross salary or \$2000 per month for a period of up to 6 months. This enhancement was part of the Government's announced off-Budget measures in October 2001.

72. Older workers can also boost their skills through broader upgrading schemes with support from their employers and the Skills Development Fund (SDF). In addition, employers can send their workers for skills upgrading under the Skills Redevelopment Programme (SRP), under

which the employers are eligible to claim subsidies of up to 100% of the course fee in some cases.

73. Government introduced the National IT Literacy Programme (NITLP) in June 2001, to help equip workers with basic Internet skills and to integrate IT into their daily lives. Older workers can leverage on the NITLP to improve their IT knowledge and thereby enhance their employability in the New Economy.

Removing Rigidities in the Wage System

74. While these schemes on skills upgrading will help improve the skill levels and productivity of older workers, they are insufficient on their own. **We have to move away from a seniority-based wage system, which is more pronounced in Singapore than in other countries, so that wages are more closely tied to skills and productivity.** However, this process will take time and may not be sufficient, because of institutional and labour market rigidities.

75. Efforts have been made to enhance the flexibility of our wage system and promote the implementation of the base-up wage system in place of the seniority-based wage system. While there has been some progress in the unionised sector with about 10% of the firms adopting the base-up wage system, the take-up rate in the non-unionised sector is low at only 2.4%.

76. Workers above 50 will be the most vulnerable to competitive pressures. They are less educated than younger workers, less readily retrained and less easily redeployed into new jobs. With a greying workforce and increasingly shorter business and economic cycles, we need to increase the incentive for companies to employ older workers by restructuring the seniority-based wage system and scaling back statutory wage components such as the CPF. Otherwise, more may become victims of an unemployment trap.

77. CPF contribution rates for workers above 55 are already much lower than for the rest of the workforce (currently, the CPF contribution rate is halved when a member reaches age 55). Ideally, however, the CPF contribution rate should step-down gradually, rather than drop suddenly from 40% for younger workers to 20% for workers aged 55 and above. We have to make similar, but more modest, adjustments for those in the 50-

55¹⁰ age group, so as to achieve greater wage flexibility and help preserve jobs for these workers. We propose that government should **keep the employer's CPF contribution rate for those in the 50-55 age group at its present level of 16%, even as we restore the CPF contribution rate to 40% for the other age groups.**

78. We also propose that the Government **lower the employee's CPF contribution rate for workers in the 50-55 age group from the present level of 20% to 16%. This should similarly be phased in as we restore the CPF contribution rate to 40% for the other age groups.** For older workers seeking re-employment in lower-paying jobs, this measure would help them by mitigating the reduction in take-home pay.

79. The overall effect of these changes will be a meaningful step-down in total CPF contribution rate, from 40% (20 + 20) for those below 50, to 32% (16 + 16) for those aged 50-55 to 20% (7.5 + 12.5) for those aged 55-61, after restoration to 40%. This will make it easier for the 50-55 age group to remain employed.

80. The intention is to increase flexibility for employing older workers and not to reduce wages or business costs. **Employers are encouraged to pass on part of their cost savings to deserving workers in this age group as the CPF is restored for the others. Employers can do so through the variable component of their wages, e.g. bonuses or the monthly variable component (MVC), depending on the circumstances of each company and the contribution of each worker.**

81. Some workers in the 50-55 age group may face mortgage payment shortfalls, especially when the Special Account and Medisave Account rates are increased to reach their target level. When the Government reduced employer's CPF contribution rate in 1999, a set of measures was implemented to assist members with mortgage shortfalls. This included allowing the use of the Special Account savings for mortgage payments. The intention was to phase out these measures when the CPF rate is fully restored to 40%. To help affected members adjust, **the Government should allow members aged 50 – 55 who have exhausted their OA savings to continue to draw on their Special Account savings for a period of time, to meet any shortfalls in their mortgage repayments due to the non-restoration of employer CPF rate.**

¹⁰ 50-55 refers to those who are aged between 50 years and 1 day and 55 years exactly

82. The employer's CPF contribution for employees aged 55 and above should be restored alongside with the younger age groups, as their contribution rates were already adjusted when the Government extended the retirement age to 62 years.

83. These proposed recommendations to enhance the flexibility of the wage structure for workers in the 50-55 age group can only be part of a broader programme to address the long-term employability of these workers. The non-restoration of the employer CPF rate for this group signals the need to address this long-term issue and must be complemented by sustained efforts through other measures, such as providing incentives for re-training and skills upgrading, and encouraging a mindset shift on the part of both employers and employees. These will be critical ingredients in preserving jobs for older workers, and helping them to meet the challenges of the New Economy.

CHAPTER 8: CONCLUSION

84. Singapore faces significant economic and social challenges in the years ahead. We are operating in an increasingly competitive global environment. We are unlikely to experience the same rates of growth in incomes and asset values in the years ahead. We are also a rapidly ageing society.

85. We need to refocus the CPF towards enhancing Singaporeans' financial security in retirement. The Sub-Committee's recommendations to adjust CPF contribution rates for the various sub-accounts (set out in **Table 3** below) would help increase the proportion of funds in the CPF for retirement income and healthcare. The proposals to place judicious limits on withdrawals for housing, and enhance investment options to improve risk adjusted returns for members will safeguard a larger amount of funds for retirement needs.

Table 3: Proposed CPF Contribution Rates

| | OA | | MA | | SA | | Total | |
|-------------|---------|-------------|---------|-----------|---------|-----------|---------|--------------|
| | Current | Proposed | Current | Proposed | Current | Proposed | Current | Proposed |
| 35&under | 26% | 28% | 6% | 7% | 4% | 5% | 36% | 40% |
| Above 35-45 | 23% | 25% | 7% | 8% | 6% | 7% | 36% | 40% |
| Above 45-50 | 22% | 22% | 8% | 9% | 6% | 9% | 36% | 40% |
| Above 50-55 | 22% | 14% | 8% | 9% | 6% | 9% | 36% | 32% |
| Above 55-60 | 10.5% | 11% | 8% | 9% | 0% | 0% | 18.5% | 20% |
| Above 60-65 | 2.5% | 2.5% | 8.5% | 9% | 0% | 0% | 11% | 11.5% |
| Above 65 | 0% | 0% | 8.5% | 9% | 0% | 0% | 8.5% | 9% |

NB: The above recommendations are to take effect in tandem with the restoration of the total contribution rate to 40%.

86. At the same time, the CPF system must support a more flexible labour market, so as to preserve jobs and maximise employment for Singaporeans.

87. Taken in totality, **our recommendations seek to strike a balance between the competing priorities of enhancing retirement security, providing for home ownership, and increasing economic flexibility.** The changes proposed by the Subcommittee will also set the parameters for the path the CPF system must take to address the challenges ahead.

Annex A

CPF SCHEMES

| SCHEME | YEAR INTRODUCED |
|---------------------------------------|---|
| For home ownership purposes | |
| Public Housing Scheme | 1968 |
| Residential Properties Scheme | 1981 |
| For healthcare purposes | |
| Medisave Account | 1984 |
| MediShield | 1990 |
| For family protection purposes | |
| Home Protection Scheme | 1981 |
| Dependants' Protection Scheme | 1989 |
| For asset enhancement purposes | |
| CPF Investment Scheme | 1986 (As The Approved Investment Scheme) |
| Non-Residential Properties Scheme | 1986 |
| Education Scheme | 1989 |
| For retirement needs | |
| Minimum Sum Scheme | 1987 |

Table: Residential Properties Scheme

| Date of Implementation | Policy Statement |
|-------------------------------|---|
| 1 June 1981 | Total CPF withdrawal cannot exceed 80% of the value of the property at the date of signing the sales & purchase agreement, as assessed by the Board. |
| 1 November 1988 | Total CPF withdrawal was increased to 100% of the value of the property, at the date of signing the sales & purchase agreement, as assessed by the Board. |
| 1 October 1993 | For CPF members whose housing loans are still outstanding when total CPF withdrawals towards the payment of the mortgage loan reach the Valuation Limit, they were allowed to use CPF savings up to the Available Housing Withdrawal Limit (AHWL, which is 80% of the gross CPF savings in excess of the Minimum Sum), or the available Ordinary Account balance after setting aside the Minimum Sum cash component, to repay the loan. |

Table: Public Housing Scheme

| Date of Implementation | Policy Statement |
|-------------------------------|--|
| 1968 | <u>For HDB new flat</u> Total CPF withdrawal is up to the full purchase price of the flat bought directly from HDB. For a HDB housing loan, CPF can be used to fully service it until the end of the loan period. |
| Nov 1983 | <u>For HDB Resale Flat</u> Total CPF withdrawal is up to 140% of HDB controlled posted price or the declared selling price of the flat, whichever is lower. |
| 1 April 1993 | <u>HDB Resale Flat</u> Total CPF withdrawal is up to the Valuation Limit i.e. purchase price or the market value of the flat at the time of purchase, whichever is lower. |
| 1 October 1993 | <u>HDB/HUDC Phase III/IV Resale Flat/HDB Resale Flat</u> |

| | |
|--|--|
| | <p>For CPF members whose housing loans are still outstanding when total CPF withdrawals towards the payment of the mortgage loan reach the Valuation Limit, they were allowed to use CPF savings up to the Available Housing Withdrawal Limit (AHWL, which is 80% of the gross CPF savings in excess of the Minimum Sum), or the available Ordinary Account balance after setting aside the Minimum Sum cash component, to repay the loan.</p> |
|--|--|

Composition of the Sub-Committee

| | |
|--|--|
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| Mr Michael Dee | Managing Director Morgan Stanley Dean Witter Asia (Singapore) Pte. Ltd. |
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| Mr Stephen Lee | President Singapore National Employer's Federation and Chairman Committee of Singapore Business Federation |
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