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Keynote Address by Mr. Don Yeo, Deputy Chief Executive Officer,
Central Provident Fund Board
At the 2nd Life Protection Seminar
(Life Insurance Association & Singapore Actuarial Society)
on 5th October 2010

"Addressing the Retirement & Protection Needs of Singaporeans"

Good afternoon
Ladies and Gentlemen

1. I would like to thank the Life Insurance Association (LIA) and the Singapore Actuarial Society (SAS) for inviting me to address this Seminar. Both the LIA and SAS have key roles to play in meeting the retirement and protection needs of Singaporeans. My address will focus on ways in which CPF Board can work together with private insurers to better meet the retirement and protection needs of Singaporeans.

Genesis of National Insurance Schemes

2. At a time when insurance protection was in its relative infancy in Singapore in the 1980s, the government introduced several insurance schemes to make basic protection available to Singaporeans. These included the Home Protection Scheme in 1981, the Dependants' Protection Scheme in 1989, and the MediShield Scheme in 1990. These schemes provide members with affordable means of meeting their basic insurance needs, and together with the CPF system itself, establish a firm foundation for our social security system.

Interface with the Private Industry

Private & Public Provision are Complementary

3. The mechanisms through which these national schemes are delivered have evolved in the 30 years since. We now tap on private insurers to supplement the basic Medishield scheme, which provides 80% of our population with basic medical protection needs. In partnership with the industry, Private Integrated Shield Plans were developed to enable CPF members to sign up for enhanced protection and benefits in the event of serious illnesses[1]. This is a good example of how national and private insurance schemes can play a complementary role in meeting Singaporeans' insurance needs.

Privatisation of National Schemes

4. Where deemed beneficial to Singaporeans, we have also been willing to go the route of privatisation. For example, following the Economic Review Committee's[2] recommendation in 2004 that CPF-run insurance schemes be devolved to private insurers, we have successfully privatised the Dependants' Protection Scheme to two market providers[3].

5. As part of our mission to help Singaporeans secure their social security needs, the CPF Board is always keen to see how we can better

[1] MediSave-approved Integrated Shield Plans offered by 5 private insurers (They are NTUC Income, AIA, Great Eastern Life, Aviva and Prudential Assurance.) may be taken up by those who desire a level of benefits (such as stays in Class A/B1 and private hospital wards) beyond what the national MediShield scheme can offer.
[2] Economic Review Committee (2004) "Refocusing the CPF System for Enhanced Security in Retirement and Economic Flexibility", pg. 5.
[3] NTUC Income and Great Eastern Life

fulfil Singaporean’s insurance and retirement requirements. There are areas where the government is probably in a stronger position than the private sector to take the lead – for example where low-cost insurance is needed by a wide base of Singaporeans. A case in point is CPF LIFE – our national annuity scheme - which will automatically include all CPF members turning age 55 from 2013 onwards.

6. However, there are also other areas where the private sector may have distinct advantages, and it is in the interest of CPF members for the CPF Board and the insurance industry to strike a win-win partnership. The private Integrated Shield Plans and Dependant Protection Schemes have demonstrated the benefits of such a partnership in improving the national insurance schemes.

Key Challenges & Opportunities for the Insurance Industry: Longevity Risk

<u>Longevity Risks & Swaps</u>

7. The phenomenon of increasing longevity and ageing population in many parts of the world is dominating the policy agenda of many countries. For instance, in Europe, governments are struggling to cope with the fiscal burden brought upon by higher pension liabilities. A common response has been to raise the retirement age together with the pension drawdown age. In the private sector space, there has been a trend for some years now of employers shifting away from traditional defined benefit pension plans towards defined contribution plans which cost less and look better on balance sheets.

8. Such longevity trends also provide the insurance industry with opportunities to develop innovative new products to mitigate longevity risks. Solutions developed by capital markets in recent years include buy-outs, buy-ins and longevity swaps which are availed to pension fund administrators, as well as annuity products which are available to individual consumers. We note that many of these product areas are still evolving and there may be scope for such solutions here in Singapore in future.

9. The local life annuity market here is small. According to statistics from the Monetary Authority of Singapore, there was a modest increment of about 2,500 new annuities in 2009, and a total stock of about 72,000 annuities in force. There appears to be scope for this market to be further developed given that Singapore is one of the fastest ageing countries in the world. Singapore's old age support ratio (based on the ratio of residents aged 15 to 64, to those aged 65 and above) has declined from 17 forty years ago, to 8 today and maybe to 4 by 2030[4]. In this regard, the LIA and SAS can play an important role in addressing the onset of increasing longevity, by collecting and sharing information on our mortality and longevity experience. Such information will not only enable better pricing of longevity insurance products but also help educate Singaporeans to protect themselves against not having enough financial resources in retirement and outliving their savings.

<u>CPF LIFE: Update</u>

10. To mitigate the longevity risk posed by higher life expectancies of Singaporeans in a more decisive manner, we have

[4] Population Trends 2009, Department of Statistics

chosen a public sector solution. As I mentioned earlier, the CPF Board has made available CPF LIFE on an opt-in basis from September 2009 onwards, and will enrol all members from 2013 onwards. We are not alone in our focus on annuitisation. For instance, in the US, the Obama administration is studying the possibility of adding an annuity option to 401(k) plans[5], and this idea has received the support of many industry experts. The UK already has the most developed annuity market in the world and is studying further reforms.

11. The concept of CPF LIFE is simple: individuals pool their retirement savings and longevity risks, so that everyone is assured of a steady monthly income for life. There are several distinct advantages offered by CPF LIFE to its participants. First, the mandatory nature of the scheme for all CPF members with at least $40,000 balances not only yields economies of scale, but more importantly, mitigates the anti-selection risk that traditionally bedevils annuity products. Secondly, to provide stability in payouts, CPF LIFE monies are invested in special Government bonds that earn an interest rate pegged to the yield of 10-year Singapore Government Securities + 1%, and with coupon rates fixed for a longer period than previously.

12. Since September 2009, more than 43,000 CPF members have signed up for CPF LIFE, committing more than $2 billion to the scheme. This is an encouraging response. Collectively, members have also received nearly $90 million in LIFE-bonuses offered by the Government to those who sign up for CPF LIFE.

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[5] 15 Sep 2010, US Department of Treasury & Employee Benefits Security Administration (EBSA) Hearing on Certain Issues Relating to Lifetime Income Options for Participants and Beneficiaries in Retirement Plans.

13. The CPF LIFE scheme illustrates how decisive steps have been taken to tackle the challenge of ageing in our society. Essentially, risks are pooled to ensure that every member gets an income for life. However, the level of payouts each member receives in the decumulation phase still depends on the amount of savings that he has accumulated over the years. In this regard, helping members to safeguard and grow their CPF savings is another key priority for the Board. I will now turn to what we are doing on this front.

Private Insurers' Role

Mitigating Investment Risks for the Individual

14. A number of factors affect whether a CPF member can accumulate sufficient savings for retirement – contributions, withdrawals, interest rates earned on CPF savings, as well as - for those who invest through the CPF Investment Scheme - how their investments perform. As the gate keeper and trustee of CPF monies, we have a duty of care to perform quality control on products that are offered to our members under CPFIS[6]. In this regard, let me elaborate on how we have worked with private insurers and financial institutions.

15. You may be aware that since 2006, the Board has sought to progressively tighten the quantitative and qualitative factors in our CPFIS fund evaluation process. The public furore over Minibonds is a useful reminder of how the public expects government agencies to do some quality control on products offered for sale to retail investors.

[6] The CPF Investment Scheme (CPFIS) currently makes up 22%, or $464 million, of single premium sales. Single premium sales jumped 36% to $2.09 billion over the first six months of this year. (Business Times, 6/8/10, "Life insurance sales register healthy growth")

While our tightening measures may dampen commercial possibilities in the CPF fund space, the Board has done so in recognition that the proliferation of choices has not served our CPF investors well. Specifically, too much choice has resulted in inferior investment performance. Our solution then, similar to what was articulated in a recent article by Investments & Pensions Asia (IPA)[7] is to create an optimal choice set in terms of quality, rather than quantity.

16. In this regard, our investment consultant Morningstar has adopted a common evaluation process for fund management companies, based on peer group comparisons and global best practices. Our end objective is to reduce the number of CPFIS funds, leaving well-diversified funds with low investment costs, good performance records and robust processes to sustain future performance[8]. We hope that through our policy intervention, investments of CPF monies under CPFIS will yield a consistent and sustainable return for CPF members.

17. In addition, just as we have held the ideal that CPF savings should not be used for consumptive purposes[9], we also discourage investments in instruments that entail significant costs, as they can severely erode investment returns and diminish retirement savings to an individual investor. The potential extent of this erosion should not be overlooked. As little as 1% in additional charges could have a very significant drag on total returns at retirement due to the compounding

[7] Richard Newell (10/9/10), "Too much member choice results in inferior performance", Investments & Pensions Asia.
[8] Taken from DCE(PCD)/ D(RI)'s letter to Mr Hugh Young from Aberdeen Asset Management (19/5/10)
[9] This public positioning of the caps on wrap fees was approved by Minister at BMM on 23rd March 2010.

effect[10]. Other research studies have also shown that funds with high expense ratios would perform worse than others with low expense ratios in terms of actual investment returns[11].

18. For these reasons, CPFB has been working to contain costs for retail investors through regulating sales charges, Total Expense Ratios (TERs). Going forward, we will also continue to carefully monitor all investment-related fees and expenses. As costs are a controllable factor in investments, we urge the industry to develop their CPF products with a strong cost-focus for the CPF investor's benefit.

Consumer Education & Corporate Responsibility

19. At the same time, consumer education is also critical in equipping members of the public with the wherewithal to make good choices. CPF Board will continue to address members' financial literacy through programmes such as MoneySENSE. We similarly urge the industry to develop simple products that are easy for consumers to understand. Along with proper needs-based sales advisory processes'[12] in place, this will ensure that consumers' financial decisions are based on a proper analysis of their individual needs and risk profiles. We believe the insurance industry is in a prime position to make a significant impact in meeting the protection needs and expectations of Singaporeans on many levels

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[10] Aug 2001, Hazel Bateman, "Disclosure of Superannuation Fees and Charges", University of New South Wales. The study showed that charges of 1% and 2% respectively could reduce retirement savings by 22% and 40% respectively over a 40 year span. The projections assume a 5% real rate of return, inflation of 0%, continuous contributions, no taxes and no insurance premiums.

[11] Russel Kinnel (9/8/10), Morningstar's Director of Mutual Fund Research. "How Expense Ratios and Star Ratings Predict Success".

[12] Straits Times (1/8/10), "Buying a policy? Here are some questions to ask to stay in the big picture"

20. In this regard, the industry has an important responsibility to ensure that the incentive structures for Financial Advisors[13] do not compromise the interests of the customer. A recent Sunday Times article has already called for greater transparency in fee-charging and commissions, for the consumer's benefit. The industry must therefore continue to place the highest importance on ensuring professional standards and integrity of insurance and financial advisors.

Conclusion: Partnership for Long-term Societal Benefits

21. All these factors will help to build an optimum environment in which Singaporeans can benefit most from simple, low-cost products which help to protect and grow their savings. Ultimately, the foundations of credibility and trust[14] are crucial not only in generating more business for insurers, but also in securing protection for consumers against risks, and more broadly, society's financial stability for the long-term.

22. To achieve this, the government will continue to look for appropriate ways to partner with the industry and private market players to achieve outcomes that are beneficial for customers, members and Singaporeans in the long-term.

23. I trust this seminar will generate useful insights to achieve this outcome, and wish you all a fruitful discussion this afternoon. Thank you.

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[13] Mr Low Kwok Mun (2009) in his keynote address at the inaugural Life Protection Seminar, paragraph 9. Accessed 19th July 2010 at http://www.mas.gov.sg/news_room/statements/2009

[14] This sentence incorporates points from Mr Tan Suee Chieh (CE, NTUC Income)'s presentation delivered at the World Risk & Insurance Economics Congress (26/7/10).