Employer-sponsored retirement schemes in Singapore – A missing pillar

Singapore Actuarial Society – Life Insurance Association

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Agenda

- World Bank pension conceptual framework
- The Singapore retirement landscape
- How do Singapore employees view retirement?
- Employer-sponsored approaches to retirement provision
- The employer viewpoint
- Issues with the current modes of provision

Retirement in the news

I don’t think many Singaporeans know that their CPF savings are not going to be enough to provide for their retirement

— Prof Hui Wing Tat, Lee Kuan Yew School of Public Policy, NUS

Source: The Straits Times, Singapore, 21 March 2012

World Bank pension conceptual framework

Pension conceptual framework

World Bank – 5 pillar framework:

1. A non-contributory “zero pillar”
   - Social pension or general social assistance typically financed by the local, regional or national government
   - Ensures that people with low lifetime incomes are provided with basic protection in old age
2. A mandatory “first pillar”
   - Objective is to replace a portion of lifetime pre-retirement income
   - Addresses the risk of individual myopia, low earnings, inappropriate planning horizons due to uncertainty of life expectancies and the lack or risks of financial markets
   - Typically operate on a pay-as-you-go basis and tend to be subject to demographic and political risks

Source: World Bank Pension Reform Primer

Pension conceptual framework (cont.)

World Bank – 5 pillar framework:

3. A mandatory “second pillar”
   - Individual savings accounts (i.e. defined contribution)
   - Participants usually subject to mortality and investment risk
4. A voluntary “third pillar”
   - Individual savings for retirement, disability or death; employer-sponsored; defined benefit or defined contribution
   - Flexible and discretionary in nature
   - Similar risks as second pillar
5. A non-financial “fourth pillar”
   - Access to informal support (such as family support)
   - Other formal social programs (for healthcare and/or housing)
   - Other individual financial and non-financial assets (home ownership and reverse mortgages)

Source: World Bank Pension Reform Primer

The Singapore retirement landscape

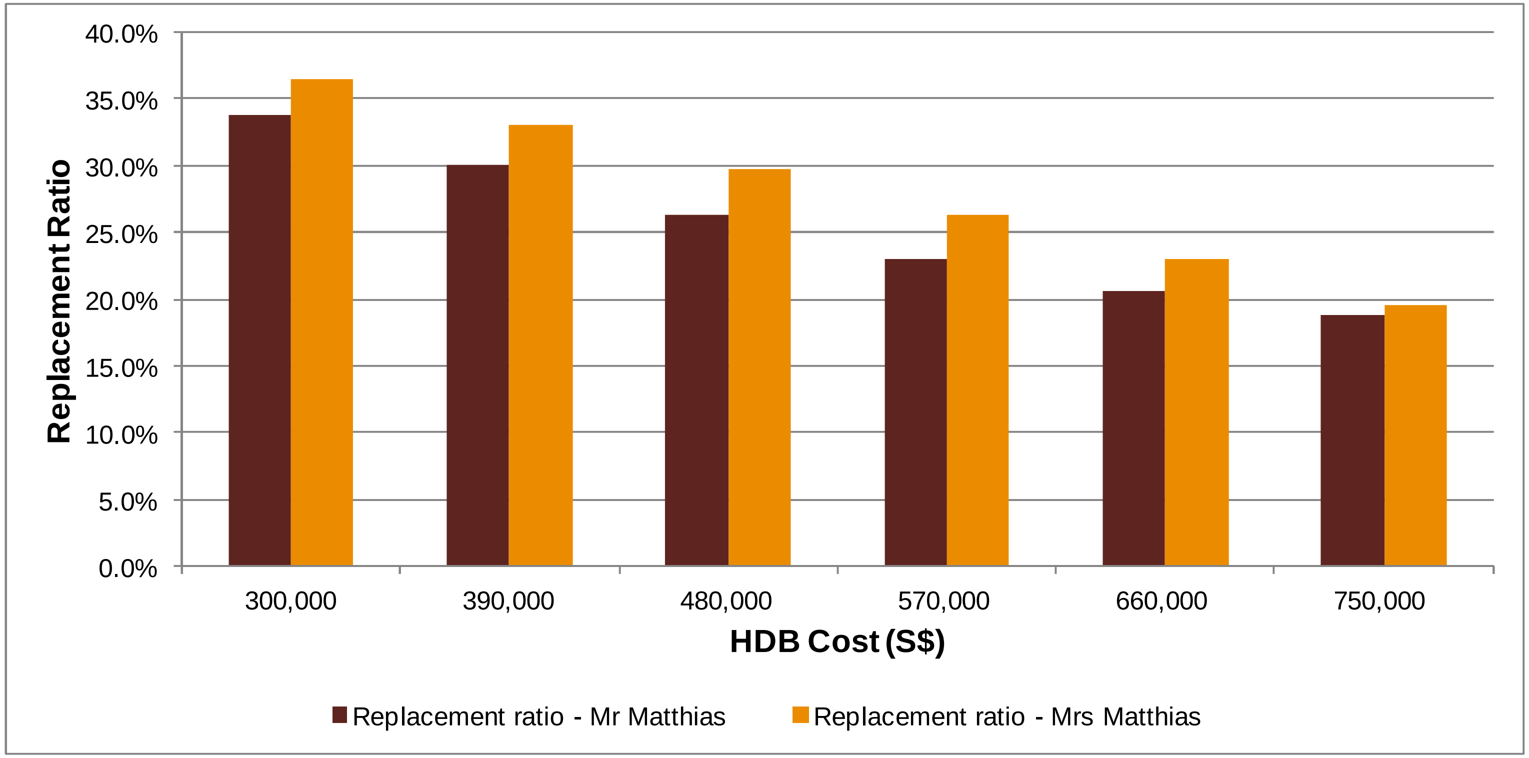
The perfect demographic storm

- Birth rate below population replacement for last 30 years – currently 1.2 instead of 2.1
- The low birth rate means there has been little choice but to be increasingly dependent on foreign talent. However foreign talent is excluded from the CPF
- Life expectancy is increasing rapidly. On retirement at age 62, life expectancy is currently over 20 years and increasing
- A few years' ago, 4 or 5 children typically financially supported 1 retired parent. Now 1.2 children try to financially support 2 retired parents and maybe 4 retired grandparents
- The combination of longer life expectancy and low birth rates means retirees need more money to fund their retirement

The perfect demographic storm (cont.)

- Post-retirement medical costs are much higher than pre-retirement medical costs
  - At age 70, hospital admission is around 10 times more likely than at age 30 and average length of hospital stay is around double
  - At age 75, medical costs are around 4 times the costs at age 55 and at age 85, medical costs are 7 times the costs at 55
- Before retirement, medical costs may be met by the employer. After retirement, you're on your own and retirement savings can easily be depleted in meeting medical costs alone
- It is generally accepted globally that post-retirement income of 66% of last drawn salary is necessary to avoid a reduction in living standards on retirement
- For an average employee, CPF provides a retirement income of around 30% of last drawn salary and for higher income employees, it provides below 20% of last drawn salary

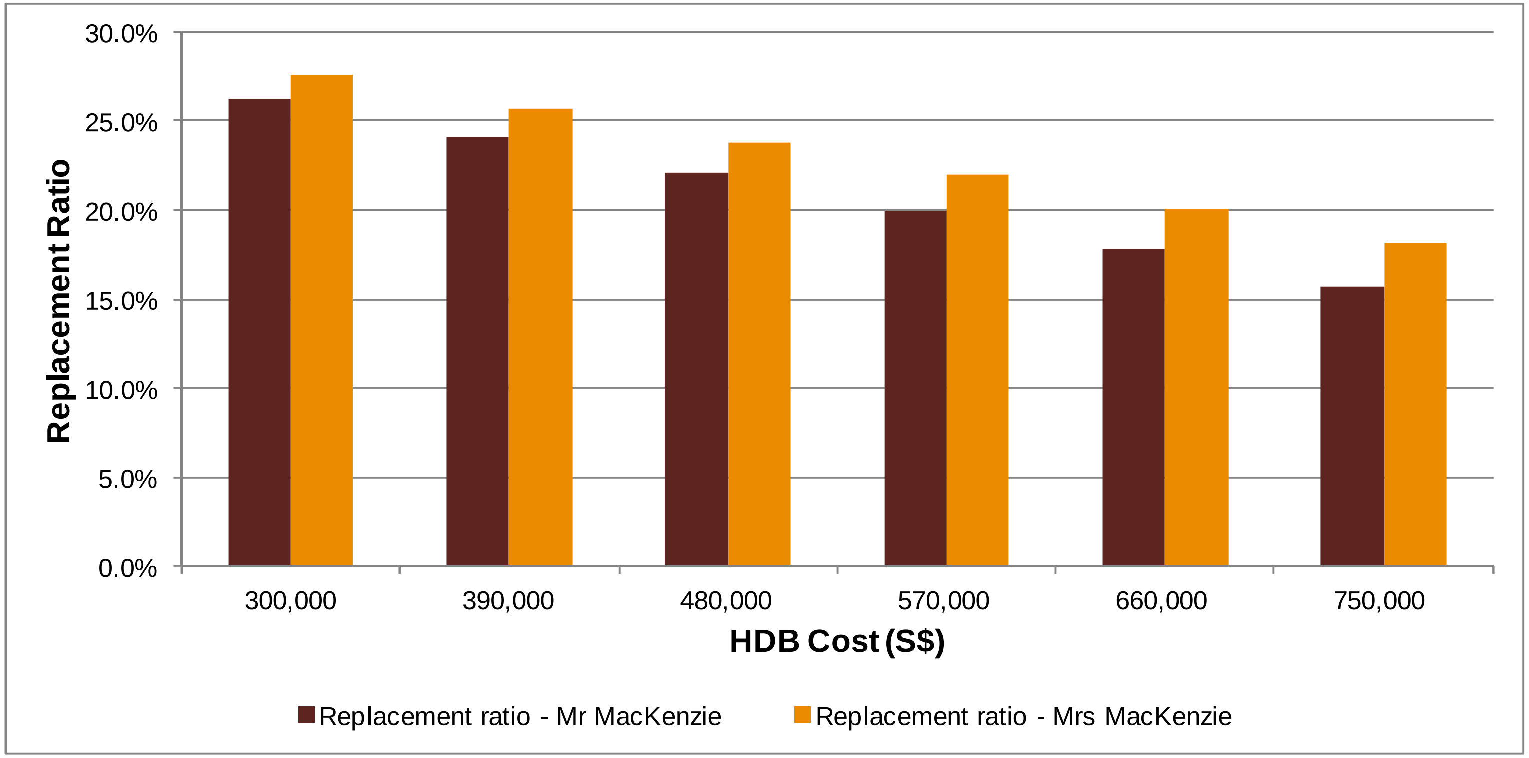
Replacement ratio examples – Mr & Mrs Matthias



Data:

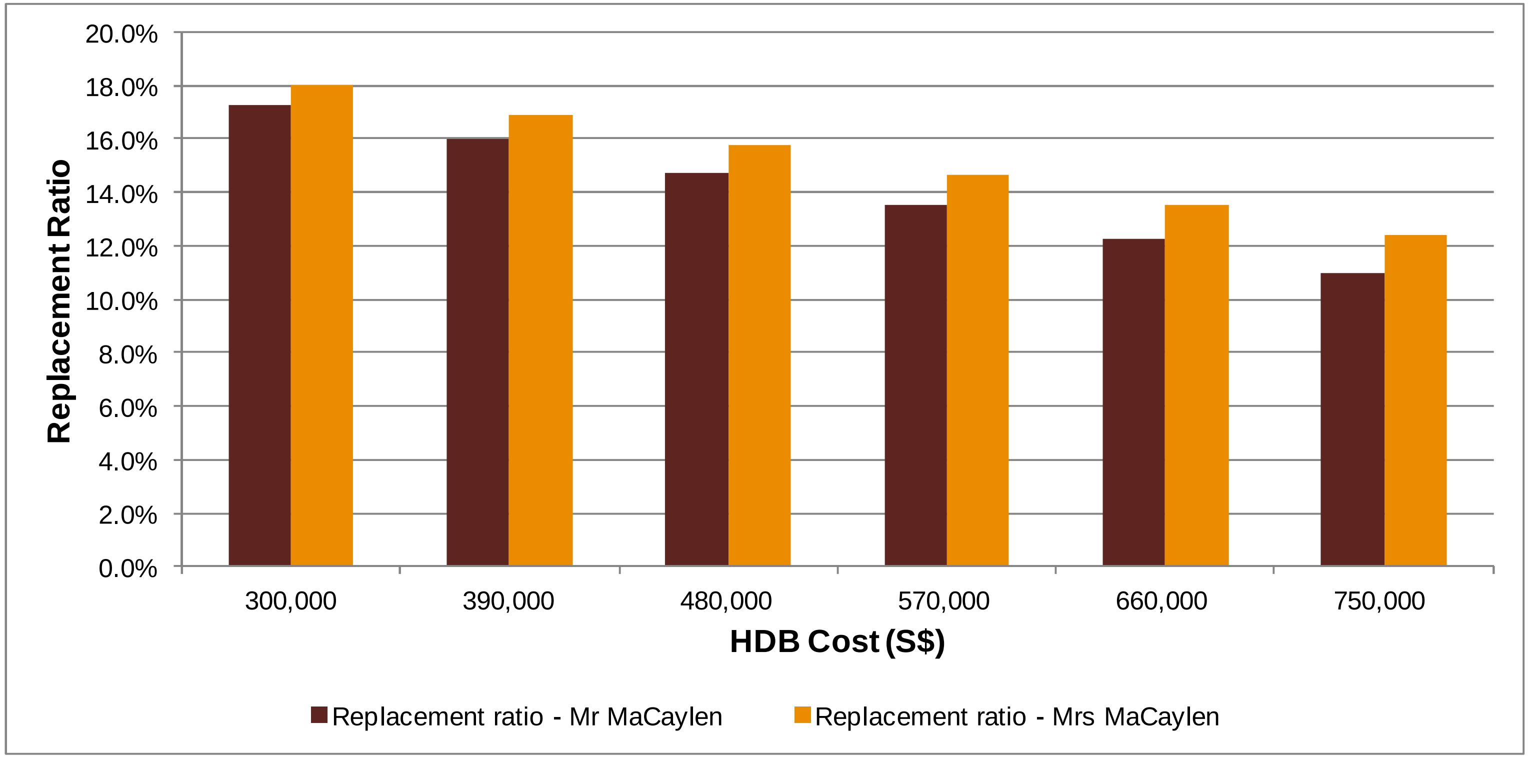
Mr Matthias current age: 25
Married age: 30
Spouse is 3 years younger
Current salary: S$1,500 per month
Number of months of bonus per year: 2 months
Salary increase assumption: 4% per annum

Replacement ratio examples – Mr & Mrs MacKenzie



Data:
Mr MacKenzie current age: 25
Married age: 30
Spouse is 3 years younger
Current salary: S$4,500 per month
Number of months of bonus per year: 2 months
Salary increase assumption: 4% per annum

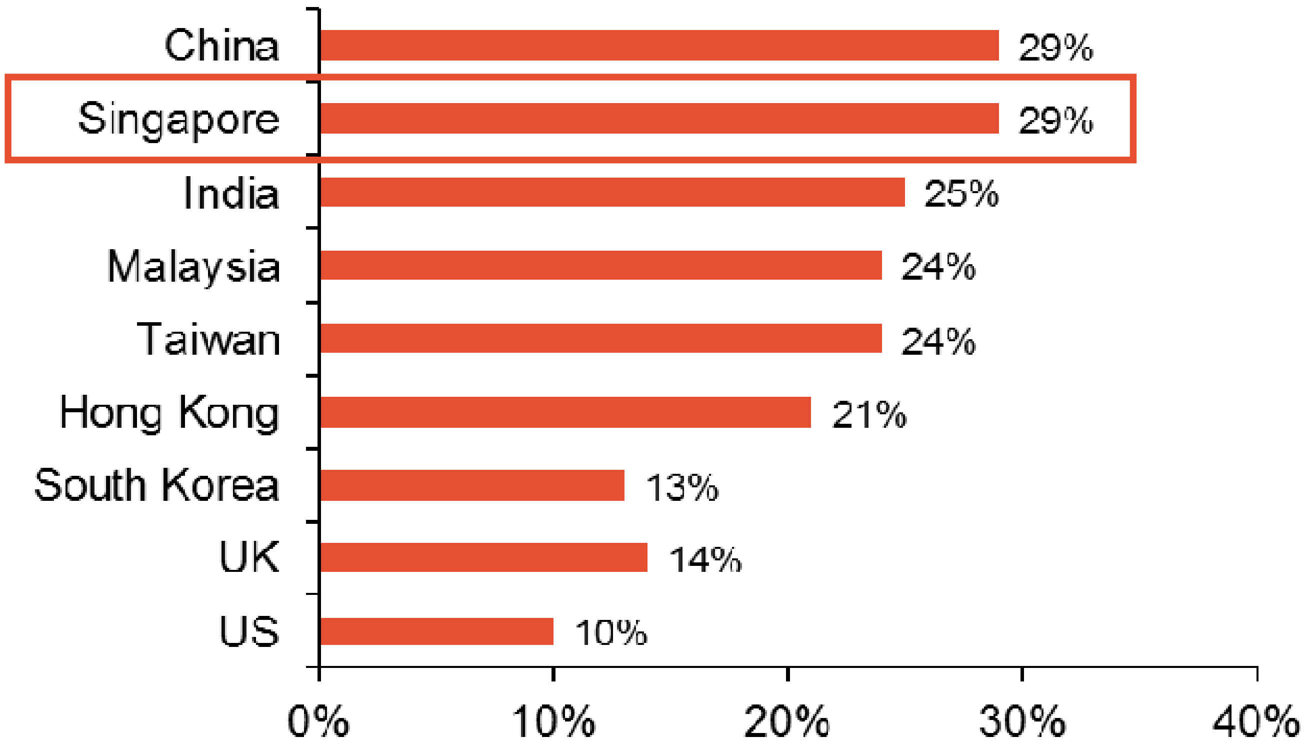
Replacement ratio examples – Mr & Mrs MaCaylen



<u>Data:</u>
Mr MaCaylen current age: 25
Married age: 30
Spouse is 3 years younger
Current salary: S$7,500 per month
Number of months of bonus per year: 2 months
Salary increase assumption: 4% per annum

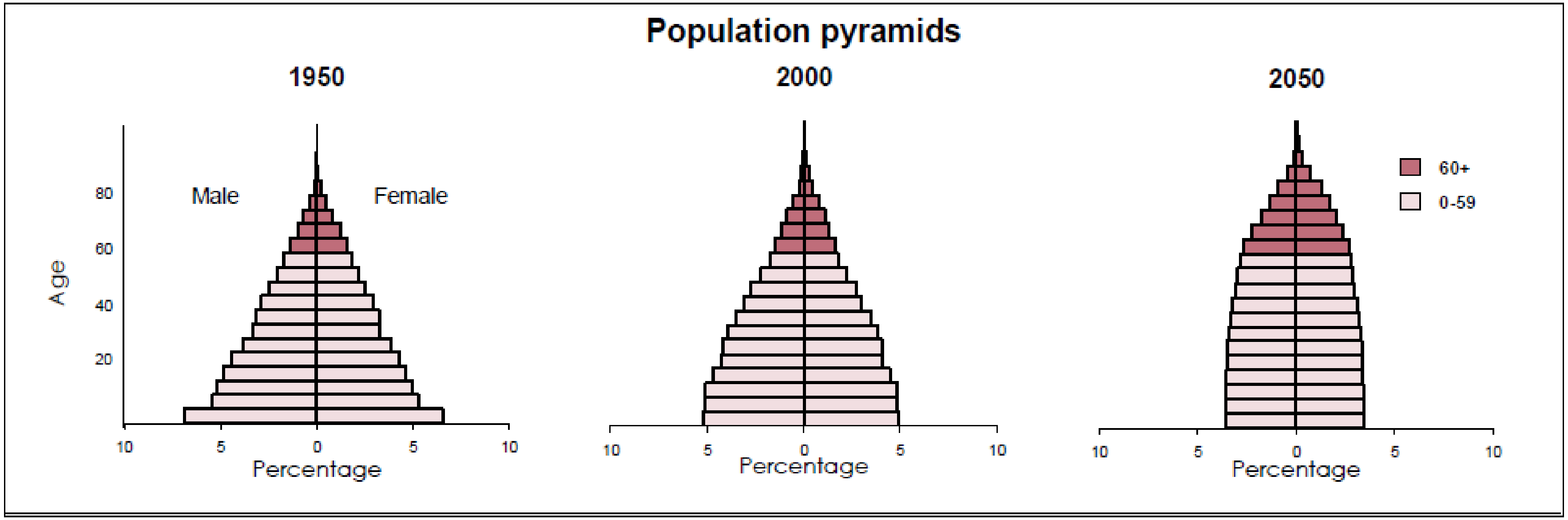
The role of family in retirement

- Q. Which of the following statements describes why you feel worried that you will not be able to cope financially when you retire?
  - A. I’m concerned about the cost of looking after my parents in their old age



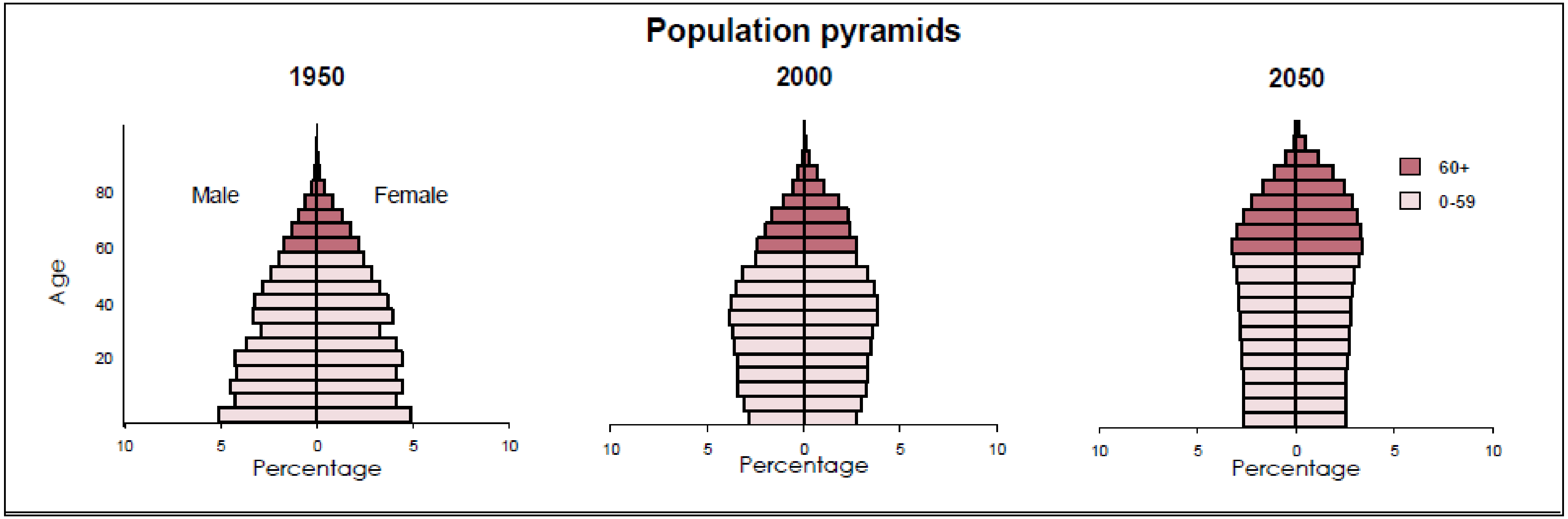
Source: HSBC The Future of Retirement 2011

World population ageing 1950 - 2050



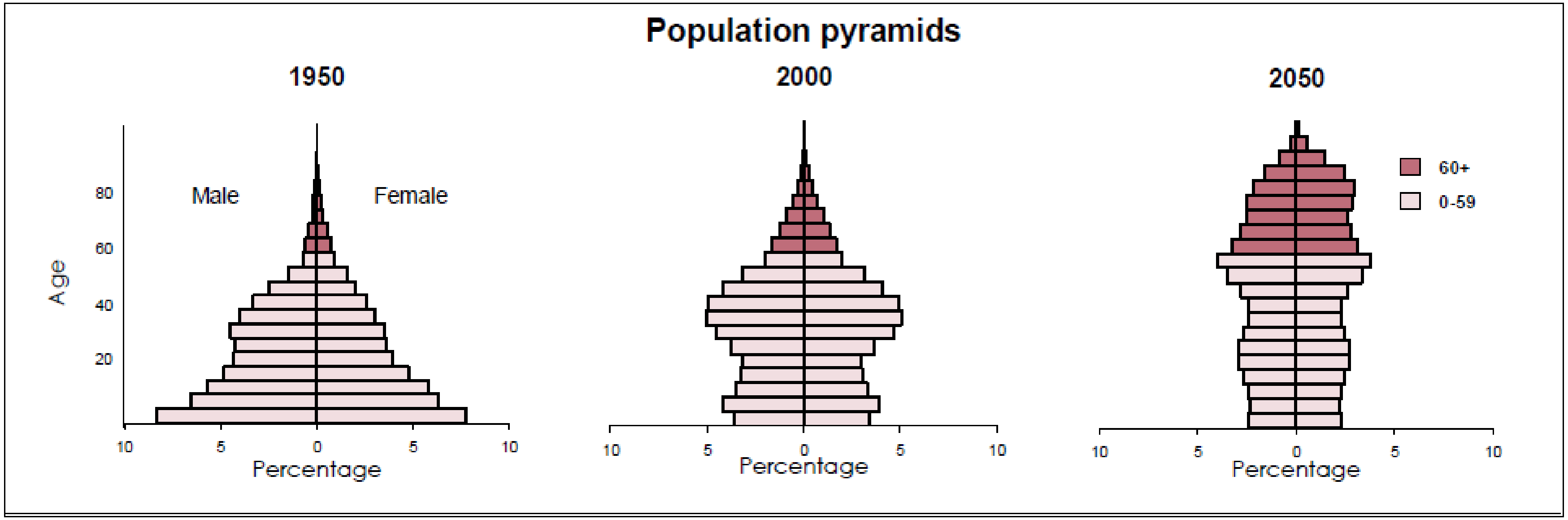
Source: World Population Ageing 1950 – 2050, Population Division, DESA, United Nations

Developed regions population ageing 1950 - 2050



Source: World Population Ageing 1950 – 2050, Population Division, DESA, United Nations

Singapore population ageing 1950 - 2050



Source: World Population Ageing 1950 – 2050, Population Division, DESA, United Nations

How do Singapore employees view retirement?

Responsibility lies with whom?

	% of respondents			
	Overall	Gen Y	Gen X	Boomers
Providing for my financial future				
Me	71	69	72	74
My employer	20	17	21	18
The government	9	14	7	9
Providing for my health care needs				
Me	52	52	54	51
My employer	23	26	24	17
The government	25	23	23	32
Providing for my retirement income needs				
Me	64	61	63	72
My employer	18	19	19	17
The government	18	21	19	11
Ensuring my individual health and well-being				
Me	77	76	78	76
My employer	14	14	14	15
The government	9	10	8	9

Source: Towers Watson Global Workforce Survey 2010 – Singapore

When do you expect to stop working altogether?

	% of respondents					
	Overall	Gen Y	Gen X	Boomers	Male	Female
49 or younger	6	13	4	0	5	8
50 to 54	9	16	9	0	7	13
55 to 59	18	20	21	8	16	22
60 to 64	34	30	35	37	33	35
65 to 69	25	14	23	47	30	17
70 to 74	5	4	5	7	5	4
75 or older	3	3	3	2	3	2

Source: Towers Watson Global Workforce Survey 2010 – Singapore

Confidence regarding retirement

Attitudes to continuing to work

	% of respondents			
	Overall	Gen Y	Gen X	Boomers
I will continue to work for financial reasons	31	25	36	27
I will continue to work to stay involved and active, but not for financial need	58	61	54	64
I will retire and not seek employment of any kind	11	14	11	9

Standard of living

	% of respondents			
	Overall	Gen Y	Gen X	Boomers
Decline	31	20	34	39
Remain the same	49	52	48	46
Improve	21	28	19	15

Only 52% are confident of having sufficient financial security throughout retirement

Source: Towers Watson Global Workforce Survey 2010 – Singapore

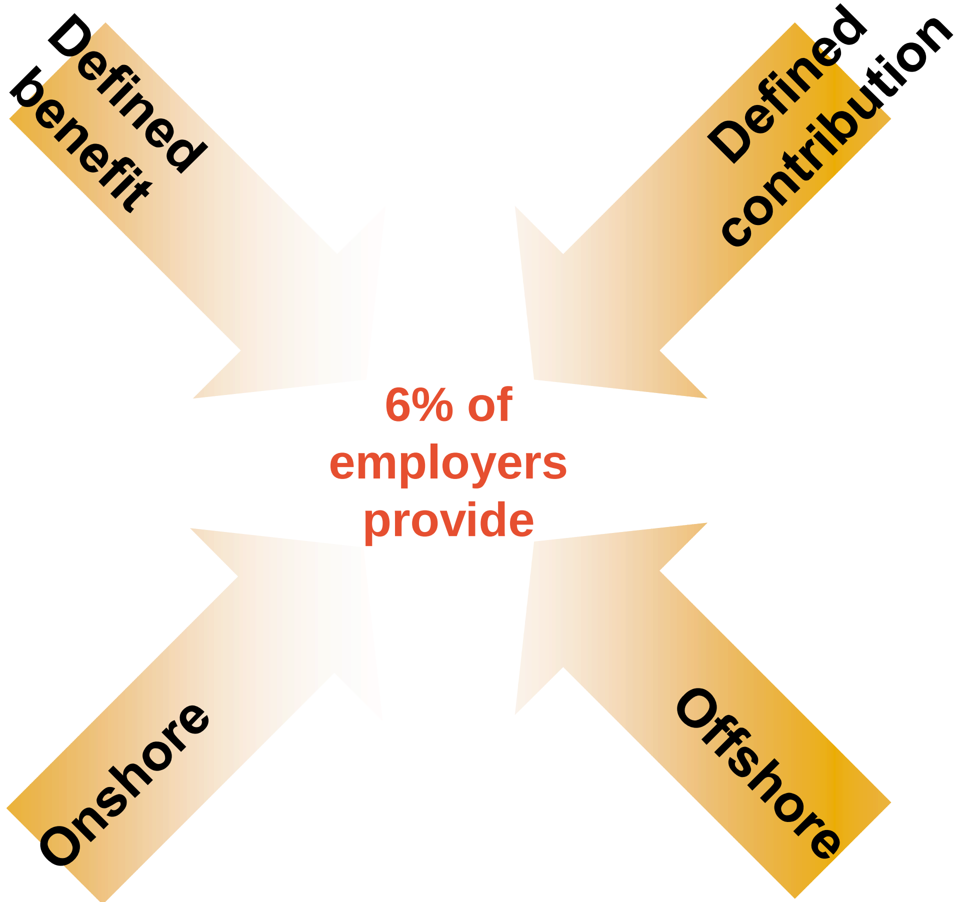
Where will your retirement income come from?

	% of respondents			
	Overall	Gen Y	Gen X	Boomers
Personal savings	84	88	82	84
CPF savings	84	84	83	88
Money from the sale of real estate	31	25	36	28
Government-provided retirement benefits (not CPF)	17	15	17	17
Other organization-sponsored programs (for example, stock options)	14	17	13	10
Inherited money	13	16	14	7
Regular monthly payments from an employer pension	12	13	12	12
Employer-sponsored savings plan	9	11	10	5

Source: Towers Watson Global Workforce Survey 2010 – Singapore

Employer-sponsored approaches to retirement provision

Supplemental retirement scheme prevalence



CPF only is the standard retirement provision in Singapore

Source: Towers Watson Benefit Data Source 2011 – Singapore

Current modes of supplemental retirement provision

Supplemental retirement schemes

Supplementary retirement scheme (SRS)

- Individual accounts established by employee through one of 3 providers approved by CPF
- Open to employer and employee contributions
- Total contributions capped at 15% of S$85,000 for Singaporeans and Singapore PRs, 35% for foreigners
- Employer contributions vest immediately
- Costs borne by employee

Section 5 scheme

- Scheme established by employer
- May be defined benefit or defined contribution
- Open to employer contributions only
- Contributions not restricted directly. Indirect cap on emerging benefits
- Vesting rules may be applied
- Costs borne by employer

Offshore plan

- Plan established by employer. Offshore trust or international pension plan (IPP)
- May be defined benefit or defined contribution
- Open to employer and employee contributions
- No cap on contributions
- Vesting rules may be applied
- Costs usually borne by employer

Unfunded arrangement

- Legacy mode of supplemental provision, generally defined benefit
- Book provision made for benefit promised by employer
- No cap on benefits
- Vesting rules may be applied
- Costs borne by employer

Supplementary retirement scheme (SRS)

- Amounts are credited to employees' nominated SRS accounts

Advantages	Disadvantages
• Amounts paid are clearly visible to the employee • Employee has a wide choice of investment options • Provider costs borne by employee • Employer contributions tax deductible, and tax neutral for employees. 50% tax concession on withdrawals • Portability • No ongoing employer involvement, other than making contributions	• The employer is not able to help establish the accounts on behalf of the employee • Limit on the contributions payable. Additional contributions may need to be channelled to an alternative vehicle for high earning employees • Immediate vesting

Offshore plan

- Typically a defined contribution is paid to an offshore vehicle

Advantages	Disadvantages
• Employer-branded arrangement • Flexibility on eligibility • Flexibility on contribution level and vesting scale • Flexibility on investment options • Tax-free investment accumulation • Proceeds tax free for Singapore-resident employees	• Employer contributions taxed as income in the hands of the employee. This creates difficulties when vesting rules are applied • Notion of “offshore” has a slight stigma

Section 5 scheme

- The employer establishes a company-wide scheme

Advantages	Disadvantages
• Employer contributions are tax-deductible • In the hands of the employee, contributions are not a taxable benefit-in-kind • Tax-free investment accumulation • Employer-branded arrangement • A vesting scale may form part of the design • Investment flexibility	• A uniform program has to be extended to all employees – no differentiation is allowed • Approval of a tax-approved trust takes time • No employee contributions allowed • Benefits are taxable • Unlikely to be economically viable for a small headcount

Unfunded scheme

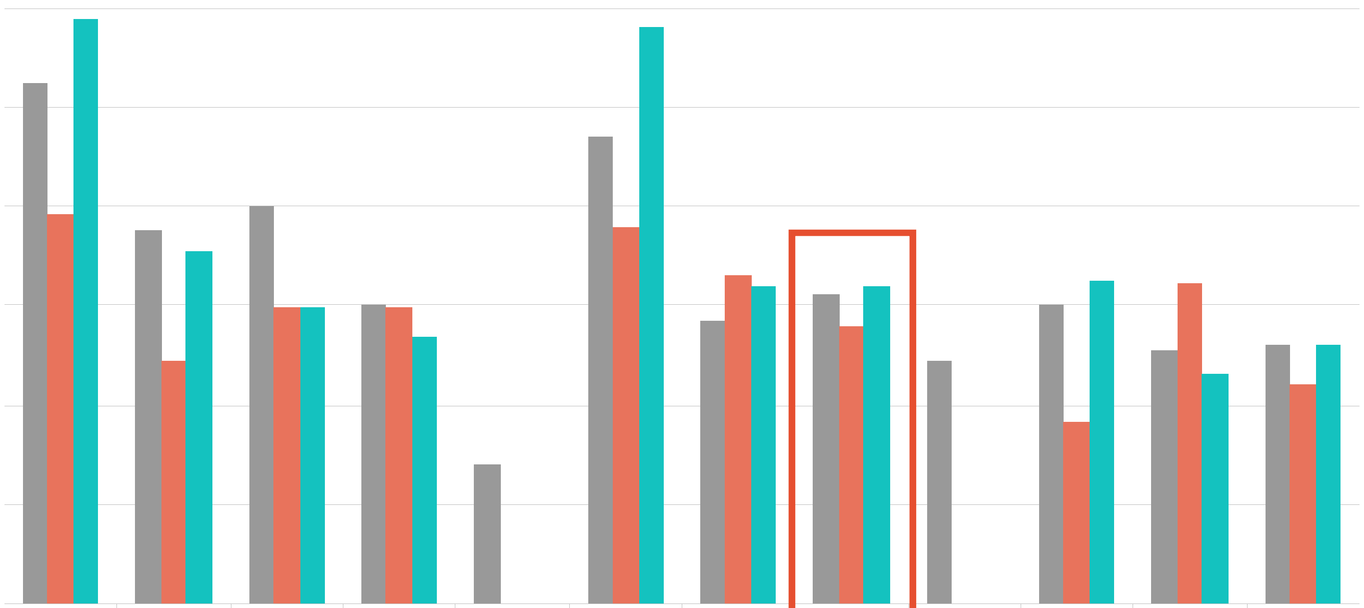
- Unfunded book provisions are made for employees

Advantages	Disadvantages
• May be a convenient way of handling a limited number of eligible employees • Ensures employer contributions are not spent on other items prior to leaving service • A vesting scale may form part of the design	• May see little employee appreciation as benefits are not tangible until exit • Administrative burden increases with increasing headcount. Amounts should be reserved on the company’s books

The employer viewpoint

Turnover rates are cause for concern

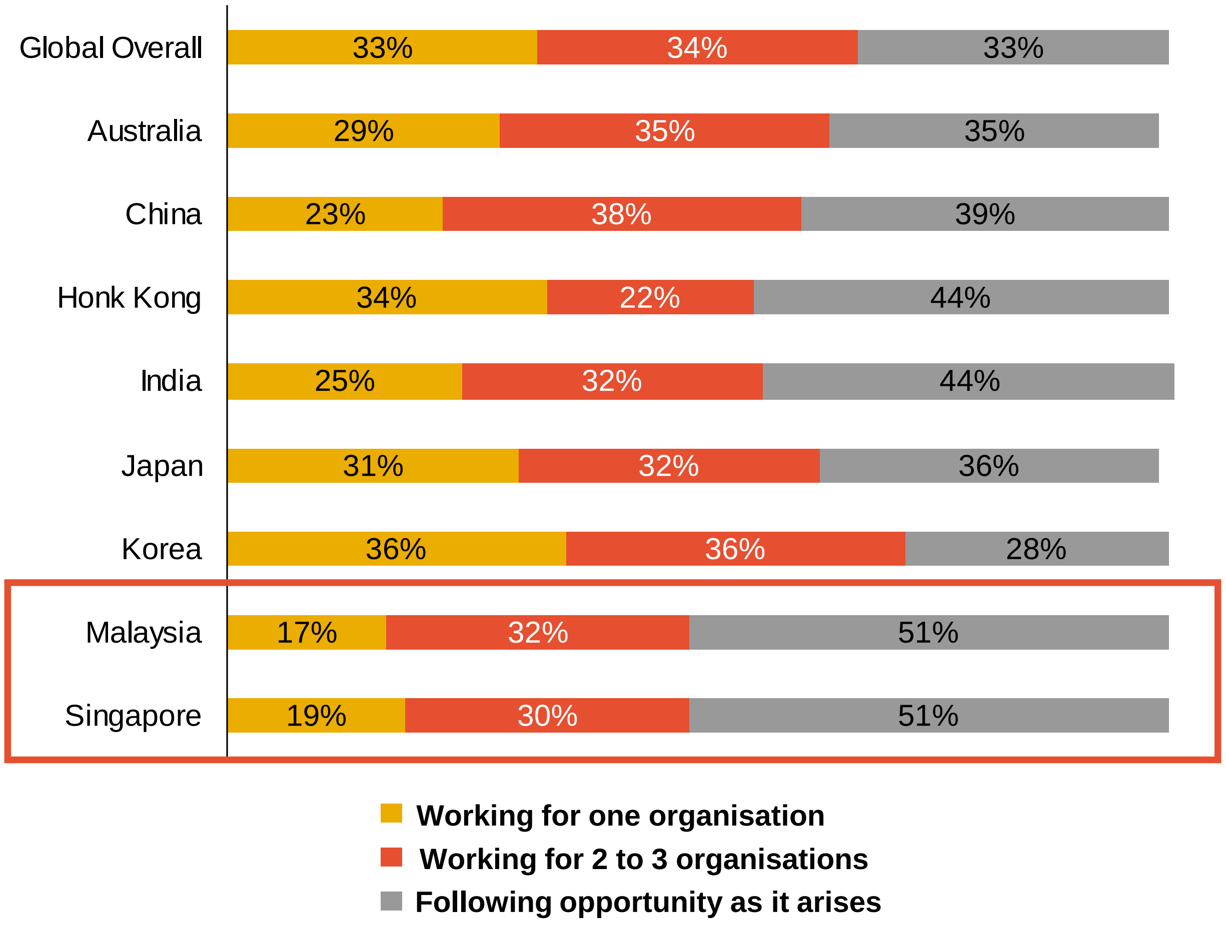
2011 employee turnover



	CHI	HKG	IND	INA	JAP	MAL	PHI	SIN	SKR	TAI	THA	VIE
All Levels	26.3%	18.8%	20.0%	15.1%	7.0%	23.6%	14.3%	15.6%	12.3%	15.1%	12.8%	13.0%
Management	19.6%	12.2%	15.0%	14.9%	-	19.0%	16.6%	14.0%	-	9.1%	16.2%	11.0%
Professional/ Supervisory	29.4%	17.8%	15.0%	13.5%	-	29.0%	16.0%	16.0%	-	16.3%	11.6%	13.0%

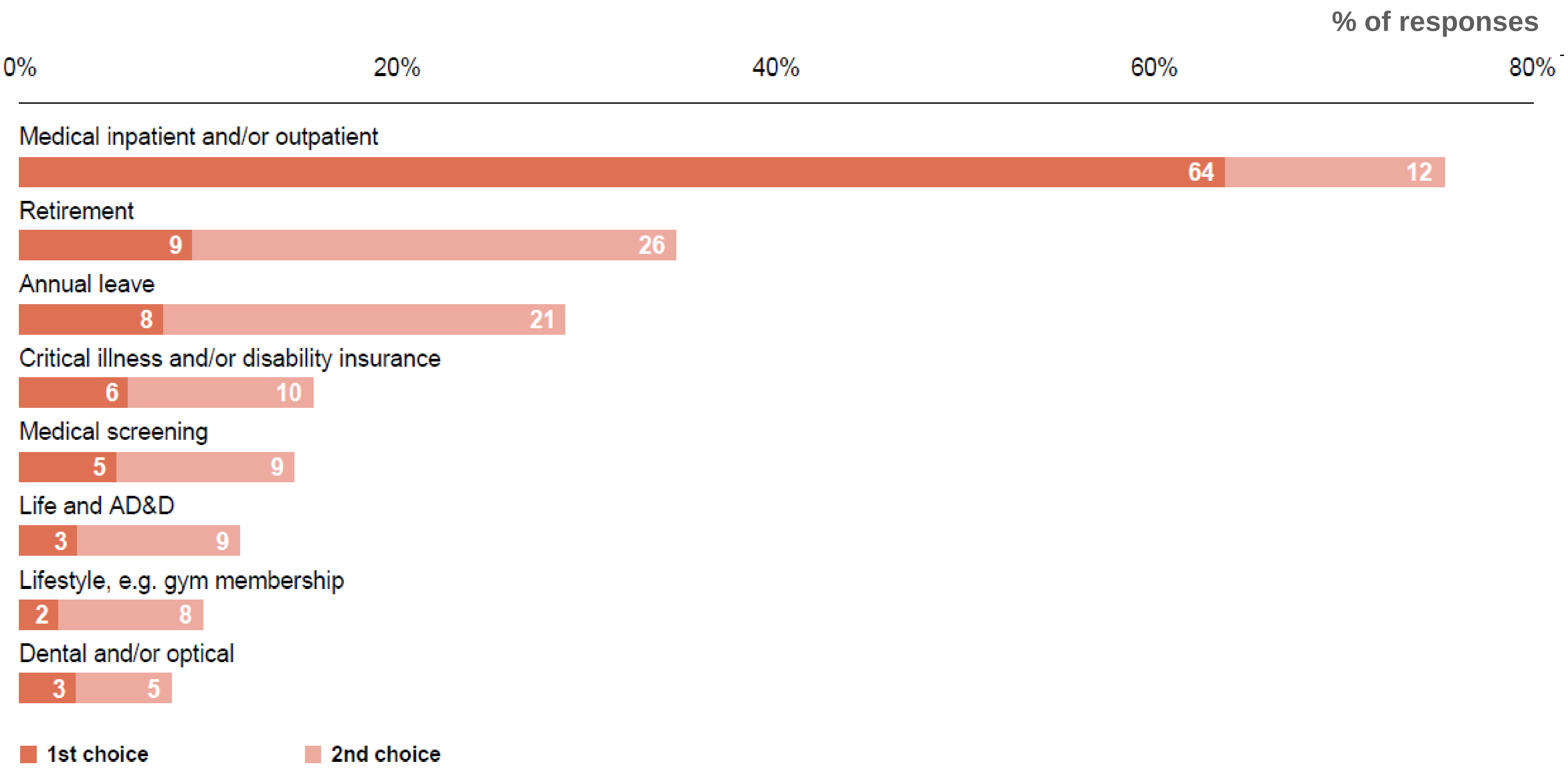
Source: Towers Watson General Industry Surveys 2011

Mobility appears to be a preferred career model



Source: Towers Watson Global Workforce Study 2010

Retirement benefits rank highly as preferred benefits across Asia-Pacific

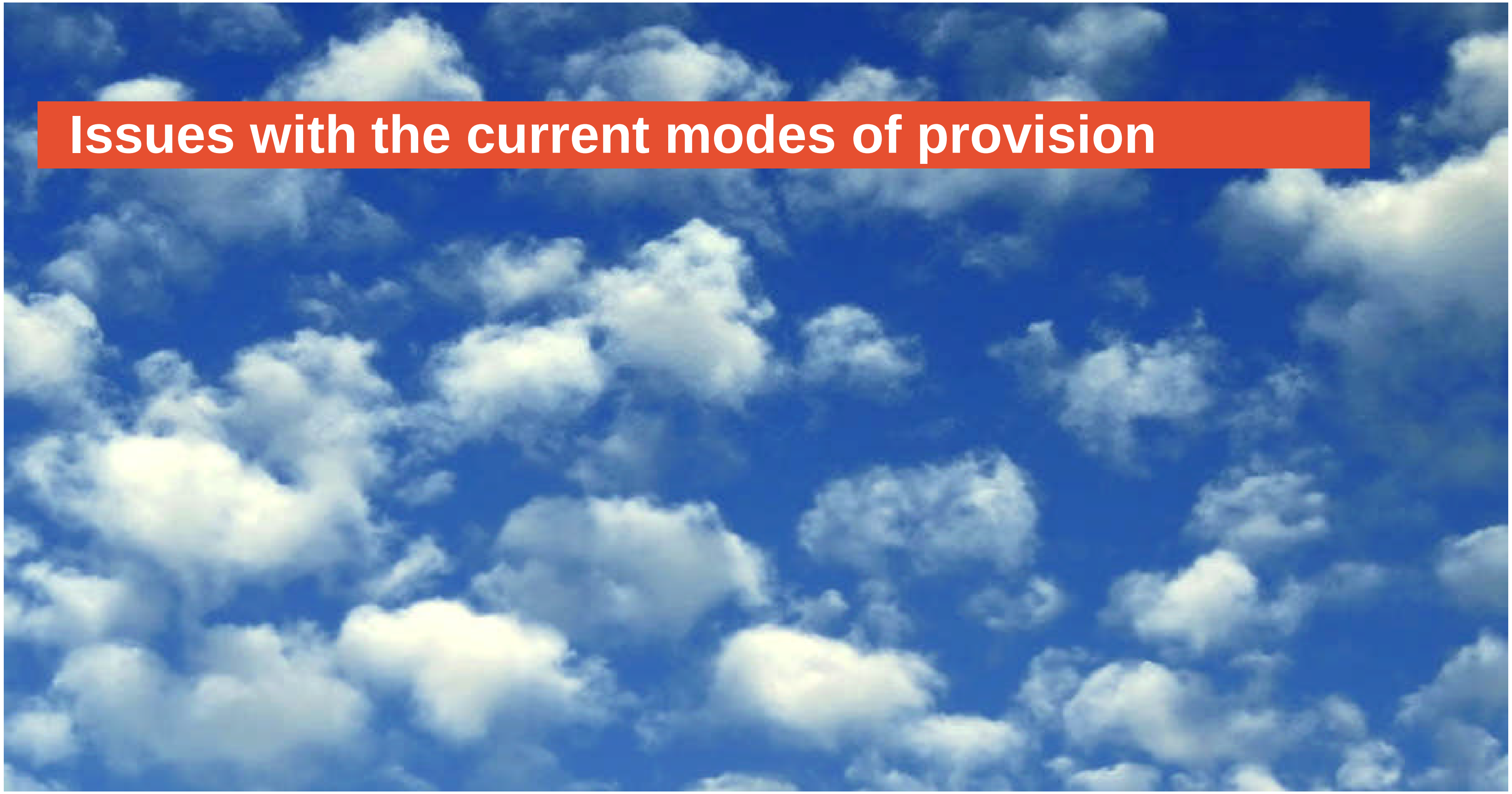


Source: Towers Watson HR Perspectives on Benefit Trends 2010 – Asia-Pacific

The employer viewpoint

- Retirement benefits are a missing item in the Singaporean reward package
- Cash compensation tends to be the primary focus
- CPF as market standard provision has tended to crowd out other provision
  - In determining benefits policy it is normal to benchmark to local industry
  - It can be difficult to make a business case in such an environment, particularly given the long-term commitment inherent in running a retirement plan
  - Inertia tends to prevail
- Employers would generally agree that the CPF may not be sufficient in retirement for many employees, particularly for higher earners
- Those with larger foreign workforces also face issues with employees who have no provision at all
- However, setting up a retirement plan can be a long process

Issues with the current modes of provision



Current issues – Supplementary Retirement Schemes (SRS)

- Contributions are voluntarily and there is little attraction for the average employee
- Appears to be mainly a tax shelter for the wealthy
- Not cost effective for employees – high investment, administration and agents' expenses
- Similar to CPFIS, it is possible that poor individual investment choices and significant administration and investment expenses have eroded investment returns
- As the benefits in the SRS vest immediately it is not an effective tool for employees' retention
- There is no scope for an employer to arrange a cluster of SRS accounts on behalf of its employees

Current issues – Section 5

- Only few companies or individuals are aware that such arrangements exist
  - There is no detailed published legislation governing the establishment and maintenance of such schemes
- Contributions are strictly employer only; employees are not allowed to contribute
- Whilst tax relief is granted on contributions paid, benefits are taxable
  - Benefit payout is treated the same as salary or bonus in the year of receipt. As the benefit has accrued over many years, this appears inconsistent
  - Benefit payout includes investment income and generally investment income is tax free in Singapore. Nevertheless, tax is levied on the full benefit payout
- Regulations allow payment of benefits in annuity form
  - However, it is difficult to place annuities, even for 5-year certain terms
- There are no portability provisions
- Approval process takes a long time

In closing…

- A re-think is needed in the way employer-sponsored retirement plans are encouraged
- Tax incentives drive behaviour
  - A shift is needed in relation to the current regulatory control – from tax protector to retirement scheme facilitator
- It is also important to promote employee participation in retirement savings
  - Engagement in retirement schemes is usually higher where employees contribute
  - There is space in Singapore for employer-arranged collective retirement savings vehicles, with institutional pricing and simple payment by salary deduction
- Communication is key to highlighting the need for long-term saving


Questions

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