Making CPF Work for You

Text by Dr Jimmy Teo, Editorial Board Member

The Central Provident Fund (CPF) scheme is a helpful tool for doctors in achieving financial and social security (eg, housing, basic utilities, food and care expenses) for when they retire from active compensated work. By global standards, a combined employer and employee contribution of almost 40% of income set aside for future expenses is a big sum. Generally, many financial advisors recommend that the average person with an average income saves about 20% of their monthly income. That said, there are many variables in old age financial and social security, and many Singaporeans worry about retirement. Why is this so? How can we use the CPF schemes to help us achieve *some* security in funding our retirement needs? Below, we briefly discuss some options. To learn more, you can visit the CPF Board website (https://www.cpf.gov.sg), attend their fairs or meet the CPF officers at the regional offices.

CPF schemes

The main schemes for social security are (1) retirement savings, (2) housing, and (3) medical expenses. The CPF has three main accounts: (1) Ordinary Account (OA), (2) Special Account (SA), and (3) MediSave Account (MA). If you are employed, a certain percentage of your CPF contributions is distributed to the OA, SA and MA. Self-employed professionals can also contribute to the CPF.

What happens when you turn 55? A new account called the Retirement Account (RA) is created. Money from the SA and OA, up to the Full Retirement Sum (FRS) of $176,000 (in 2019), is transferred to the RA. When you reach your retirement age (also the payout eligibility age, currently at 65), the money in the RA purchases CPF Life (an annuity scheme) which will pay you a monthly income for as long as you live. There are a few variations but most people pick the standard plan. You can receive a higher payout if you choose to defer your payouts up till 70 years old.

How do you earn money?

You can earn through tax savings and paid interests on the savings in the accounts. CPF contributions from earned income are tax-deductible up to a limit. Salaried and self-employed doctors should take advantage of voluntary **cash** contributions to reduce their taxable income. If you contribute to the CPF account (RA or SA) of a non-working spouse, parent or grandparent (in-laws included), or sibling, you may be eligible for tax deductions under the retirement sum top-up scheme. Do note that the current personal income tax relief cap of $80,000 applies to the total amount of all tax reliefs claimed, including any relief on cash top-ups. For example, if you pay the top tax rate of 22% and qualify for $7,000 tax relief, you save $1,540. However, if you are a Singaporean woman doctor with several Singaporean children, you will exceed the $80,000 cap with the working mother child relief. Do note that savings vary according to your rate of tax.

You earn interest from all accounts. The first $60,000 of all accounts earn 1% extra. If you are 55 years or older, you earn an extra 1%. The OA earns 2.5%, whereas the MA, SA and RA each earns 4%. Do note that the rates may change and the extra interest earned is subject to contribution limits from the OA.

CPF "hacks"

Self-employed doctors should actively contribute to their CPF accounts as a means of protection from creditors in the event of bankruptcy (https://bit.ly/2uXZ3Lq)! Other than moving to Alaska, the CPF is every Singaporean's back-up plan.

If you cannot consistently earn more than 2.5% per year from your investments (and not lose your capital), you should not use the OA to fund the purchase of your primary residence. Using all your OA savings and subsequent contributions to purchase a primary residence is not an investment and may lead to old age insecurity; unless you intend to sell your home and downgrade your living space when you retire, or rent out rooms for income. Moreover, using a big proportion of your income to build wealth through a primary residence early in life is highly risky! You are putting a lot of money into a Singapore property, valued in Singapore dollars, limited to only a residential property type, in one location, with a large mortgage over a long duration, and an asset with a declining lease and thus, value. Fundamentally, in the absence of company pension plans, your CPF in total is a pension plan and you should aim to maximise the earnings from the accounts, as this is how your social security is constructed!

If your spouse is not working, or took time off work, and is not contributing to CPF, you can consider transferring the money from your OA to your spouse's SA up to the limit of the FRS (interest rate goes up from 2.5% to 4%). However, it is recommended that you only transfer from your OA up to a limit calculated as [FRS - (55 – Spouse's age) x $7,000]. This will allow you to continue to take advantage of tax relief from cash top-ups till your spouse turns 55 (RA sum is used to fund CPF Life). There is a trade-off in doing this though – in terms of the extra 1.5% interest coupled with compounding a larger sum over a longer time period versus the tax savings on $7,000. Moreover, it depends on how you intend to fund the extra savings to reach the Enhanced Retirement Sum (ERS) in order to get the higher payout (estimated at $1,960 to $2,110 per month). Do read about the other hacks available (http://bit.ly/2RJv47X), just before you or your spouse turn 55, in further optimising your CPF earnings around the time the RA is created.

CPF investment scheme

You can apply to use savings in excess of $20,000 in the OA and $40,000 in the SA for investment. It is generally hard to achieve good returns net of inflation higher than 4%, so most people recommend not using the SA. You can open a CPF investment account with banks or brokerages and fund it using your OA. OA can be used to purchase individual stocks, mutual funds and gold. Do note that these accounts may charge fees for transactions and also custody fees based on the number of investments every quarter. Often, investors prefer investing in an exchange traded fund (ETF) of a broad market index (usually the Straits Times Index) to capture long-term growth and minimise currency loss, transaction fees, tax, account fees and other costs. Currently, the STI ETF yields more than 3.5%.

Investing the SA at age 54 years and 11 months

As a higher income earner, you may have accumulated OA savings in excess of monies used for housing or CPF investment account limits. Just before your RA is created at 55, you can withdraw your SA to invest in a relatively "safe and capital protected" investment (see links below). When you turn 55, your RA is created, and if the SA is inadequate, OA money is transferred up to the limit of the FRS. This "hack" allows you to use OA money to earn the higher 4% rate in the RA. To execute this hack well, read more and plan ahead. SA can also be used to purchase Singapore Government short-term treasury bills. Links: http://bit.ly/2RM8sE9 and http://bit.ly/2GfJMyj.

When you turn 55, transfer money from your OA to your RA until you reach the ERS. So even more of your OA money earns the higher interest of 4%. Then you exit your SA investment, which then returns the invested money to your SA. By the age of 55 and several months, you would have as much of your "stuck" money in CPF firing on all cylinders earning the highest interest rates possible!

When you turn 55, keep all monies in the CPF! That is because the interest rate floor of the OA is 2.5%. Unless you intend to wisely invest the withdrawn OA money, it is better to use the OA as a savings account and withdraw only what you think you need. Some financial bloggers have likened the OA savings after 55 to the bond portion of your investment/retirement portfolio. This is because the Singapore Government is rated triple-A and promises to pay you 2.5%, so there is no need to buy any other bonds or bond funds unless you wish to diversify your retirement portfolio away from Singapore dollars. At the time of writing, a 12-month fixed deposit in a local bank earns only about 1.5% interest and there are penalties for early withdrawal!

Flaws and weaknesses of the CPF

In order to meet its obligations to you, the CPF Board purchases special government securities to earn interest income. These securities are only available to the CPF Board and the money is invested by the Government Investment Corporation. The long-term acquisition of assets becomes part of the Government but you remain as an individual retirement savings account holder. It is only a cash savings account and therefore, you are not the true owner of the accumulated wealth!

Additionally, there is a risk of loss of purchasing power and your retirement savings are only as good as how Singapore is doing. Economic, fiscal and monetary policies may affect the true value of your CPF savings. All the wealth is denominated in Singapore dollars and is reliant on the ability of the Government of the day to meet the obligations of the CPF. Interest rate reductions will have an impact on your plans.

Individual circumstances vary

The Government provides social security and the way it does is through the CPF. However, you must do your part in planning and utilising the schemes! That said, CPF is only a part of your old age security and diversifying wealth and income sources would further improve your old age social security needs. Individual circumstances vary due to their life journeys. Doctors are usually very busy people and may not have enough time to actively manage investments. Using the CPF schemes wisely helps you to earn without much effort. These CPF schemes will help Singaporeans and their families achieve adequate social security. ◆

Disclaimer: Information correct till end-2019. Please check original source for most up-to-date information.

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