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FirstPrincipal financial

A SURVEY OF ANNUITY OPTIONS FOR RETIREMENT

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An annuity is a long-term financial hedge against the risk of living too long. An annuitant (usually a retiree) can depend on its guaranteed cash flow to meet monthly expenses at a desired standard of living. The income from an annuity is predictable and secure. In the case of a participating and investment-linked annuity, there is also the possibility of protection against inflation.

In an annuity, there is no danger of one's retirement capital being frittered away in speculative investment, the possibility of premature consumption, or worst still, the unimaginable, being defrauded of one's retirement nest egg. The purchase consideration, normally in the form of a single premium payment, is professionally managed both for investment growth and a draw down income. The discipline of living within one's annuity cash flow is inherently imposed on the annuitant.

A decent size income flow from an annuity is indispensable to one's desired standard of living during retirement. Because of its predictability, security and potential for growth, an annuity is the classic cash flow management tool during retirement, and affords a retiree real peace of mind.

CPF MINIMUM SUM SCHEME (MSS) & MINIMUM SUM PLUS SCHEME (MSPS)

A discussion about annuity options for retirement cannot be complete without examining the role of the CPF MSS and MSPS. The minimum sum was set at $80,000 in 2003. Adjusting for inflation, it is being raised gradually until it reaches $120,000 in 2013. From 1st July 2009, the CPF minimum sum will be increased from $106,000 to $117,000.

The MSS provides CPF members with a monthly income to support a modest standard of living during retirement, while the MSPS further encourages Singaporeans to save more for retirement.

THE MSS PROVIDES CPF MEMBERS WITH THREE OPTIONS, NAMELY:

1. Leave the minimum sum with the CPF Board and at your statutory draw down age, begin to draw down an income.
2. Buy an annuity from an approved life insurer.
3. Leave your minimum sum with an approved bank and draw down an income at your statutory draw down age.

As of 1st July 2008, only two companies, namely, Aviva Ltd. and NTUC Income, participated in the MSS annuity scheme *(refer to Table 1)*. As can be seen from the chart, NTUC Income offers a much better annuity, compared to Aviva. As a participating annuity, NTUC Income's monthly payouts are higher, and the prospect of increased payouts is also higher. The annuity scheme offers participants an opportunity to participate in the profits of the life fund whenever the firm declares any distributable surpluses arising from its investments.

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A participating annuity, as a result, enjoys the prospect of potentially higher returns and also possible protection against inflation, while a non-participating annuity pays a fixed payout throughout the term of the plan. Therefore the real value of a non-participating annuity will be eroded by inflation over time. If you can afford it, choose a participating annuity.

Table 1 also shows current realities. It is desirable to leave your MSS with the CPF Board and draw down an income of $910 a month for 20 years, compared to buying an annuity with NTUC Income. The difference in payout between these two alternatives is significant and difficult to ignore. The disparity in monthly income is almost 50% less for a male or about $300, and 60% less for a female or around $340 of a difference.

If you are male, it will take 20.4 years before your NTUC Income monthly annuity payout of $607.80 can equal what the payout of $910 gives you from the CPF Board. If you are female, the timeframe stretches to 23.7 years. This is assuming that NTUC Income can maintain the monthly payout at 2% increase per year on your annuity benefit, over the next 20 years.

The drawback with leaving your minimum sum with the CPF Board is that all the money in the minimum sum will be depleted in 20 years' time, at age 85. There will be no income for you after that if you survive beyond age 85. It is prudent that an additional source of annuity income be started at the same time, as you draw down your minimum sum.

MSPS was introduced in January 2001. Under this scheme, CPF members can buy life annuities beyond their minimum sum. Money channeled into the MSPS is a useful alternative. It provides an additional source of funding for your annuity payment stream.

From age 55, CPF members can utilise their CPF savings beyond the minimum sum for this scheme. The maximum limit allowable under MSPS is set at the same amount as the MSS. Income from these annuities is accorded tax exemption similar to the MSS.

TABLE 1 **CPF MINIMUM SUM SCHEME** — **TABLE OF MONTHLY PAYMENT RATES FOR THE MINIMUM SUM OF $106,000 PLACED WITH A PARTICIPATING INSURANCE COMPANY**

IMPORTANT NOTE: Information and rates are correct at date of print and are subject to changes. Please refer to the insurance companies for clarification. *Source: CPF website.*

		MINIMUM SUM USED TO PURCHASE ANNUITY AT AGE 55					
			Annuity rate at entry age of 55		Benefits		
Features	Options	Insurance Company	**Male** ($ / per month)	**Female** ($ / per month)	Guaranteed Period / Guaranteed Amount on Death	Other Benefits	Period of Payment
Monthly Annuity Payment Starts From Draw Down Age 64	Insurance Company	NTUC Income	607.80	569.55	Single premium accumulated with interest at 2.5% p.a. and bonuses up to draw down age 64 less total annuity payments made to be returned to CPF Board	The annuity will participate in the profits of the Insurer	1. Annuity income is payable for life. 2. All annuity plans provide a guaranteed return of capital on death or upon termination before draw down age.
		Aviva Ltd	502.00	467.00	Return of a lump sum equal to the premium plus all accrued interest compounded at 1% p.a. up to the commencement date of annuity payment less the total annuities paid to CPF Board		
CPF Board			**910.00**	**910.00**			

NOTES:
1. The annuity rates given are subject to the terms and conditions of the annuity plans of the insurance companies.
2. Annuities participating under MSS are either guaranteed for a certain period or a certain amount in the event of death of the annuitant.
   a. **Guaranteed Period:** Should death occur during the guaranteed period, the remaining annuity payments would be converted into a lump sum to be paid to the annuitant's CPF beneficiaries.
   b. **Guaranteed Amount:** Should death occur, the guaranteed amount less the total amount of annuity payments made would be paid to the annuitant's CPF beneficiaries.
3. Rates quoted under NTUC Income are valid for members whose draw down age start at 64. Members with other draw down ages should refer to Ins. Co. for more details.
4. Members who purchase Aviva Ltd's MS annuity will only be able to start their annuity payouts from age 65.

NATIONAL LONGEVITY INSURANCE COMMITTEE (NLIC) AND CPF LIFE

Data from the Singapore Department of Statistics show that life expectancy has increased among Singaporeans over the years. The life expectancy at birth, in 1960, was 63 years but has increased to 80 today. Among those aged 65 in 2007, 66% can expect to be alive at age 80, and 48% at age 85. Life expectancy is expected to increase for future cohorts, as it has occurred in other developed countries.

The government set up NLIC in September 2007 in response to this trend of increasing life expectancy. NLIC is also looking into the issue of basic, affordable, fair, as well as, flexible options for a national lifelong retirement income scheme utilising the savings of CPF members. The end product is CPF Life – a national annuity scheme to be operated by the CPF Board. It is due for implementation in September 2009.
The full report from NLIC is available at CPF's website as at this date of printing. Go to *http://mycpf.cpf.gov.sg/Members/Gen-Info/CPF_LIFE/NLIC.htm* to access the information.

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CPF LIFE

CPF LIFE is a new national annuity scheme that will be launched in September 2009, to provide members with a lifelong income. Through this scheme, members will receive a monthly income for as long as they live, the amount depending on the cash savings they have in their retirement account (RA).

UNDER THE CPF LIFE SCHEME, THERE ARE FOUR ANNUITY PLANS TO CHOOSE FROM, NAMELY:

1. Life Balanced Plan, which is the default plan. It is applicable to those born from 1958 onwards with at least $40,000 in the RA at age 55, and who have not chosen a plan when enrolled in CPF Life. There is a balanced level of payout for the annuitant and some bequest for the annuitant's beneficiaries.

2. Life Basic Plan that pays the lowest monthly payout for the annuitant, but the highest bequest to the annuitant's beneficiaries.

3. Life Plus Plan that pays a higher payout to the annuitant and a lesser bequest to the annuitant's beneficiaries; and lastly,

4. Life Income Plan that pays the highest payout among the four plans, but leaves nothing to the annuitant's beneficiaries in the event of death.

Furthermore, to encourage CPF members (Singapore citizens only) who were born before 1963 to enroll in the CPF Life scheme, the government will top-up the RA of the enrollee up to a maximum of $4,000. This is called the LIFE Bonus (L-Bonus) top-up. The amount of top-up a member will receive for CPF Life will depend on your age, annual assessment income, annual value of your property, and the quantum of balance in your RA account. Some members may not qualify for this top-up.

As an illustration: a male member who is age 62 in 2010, with a RA balance of $67,000, and who qualifies for $4,000 L-Bonus, will receive a monthly payout ranging from a low of $360 to a high of $440, depending on which one of the four plans he enrolls himself in. *(See Table 2, Example A for details.)*

TABLE 2 **CPF Life Illustrative Monthly Payouts**

Source: CPF Life Brochure and CPF Website.

EXAMPLE A	**Illustrative monthly payouts for male member age 62 in 2010 with RA balance of $67,000 and qualifies for L-Bonus of $4,000**			
	Life Basic	**Life Balanced**	**Life Plus**	**Life Income**
Monthly payouts from age 62	$360 to $380	$380 to $400	$390 to $410	$420 to $440
EXAMPLE B	**Illustrative monthly payouts for male member age 55 in 2013 with RA balance of $67,000 and does not qualify for L-Bonus of $4,000**			
	Life Basic	**Life Balanced**	**Life Plus**	**Life Income**
Monthly payouts from age 62	$530 to $580	$570 to $620	$600 to $660	$640 to $700

Monthly payouts are shown in ranges as payouts would be adjusted depending on the actual interest rates and mortality experience. The interest rate assumption used in the examples above varies between 3.75% and 4.25%. They do not represent the lower or upper limits of the payouts.

For a second illustration: a male member who turns 55 in 2013, with a RA balance of $67,000, and who does not qualify for L-Bonus, will receive a monthly payout ranging from a low of $530 to a high of $700, depending on which plan is chosen. *(See Table 2, Example B for details.)*

Whatever your choice, it is pertinent to note that all four plans are not indexed to inflation. What are the implications?

In the first illustration, the male member who survives 20 years will see inflation reducing the purchasing power of his monthly payout. Inflation at a consistent 2% per year will reduce $360 to $242 in real value. If inflation is at 3%, the payout of $360 will be worth $199 in real terms.

As can be seen, the real purchasing power of your CPF Life annuity income will be gradually eroded by inflation, an insidious thief of time. The higher the inflation rate the more severe the erosion of real purchasing power. This is not a tenable position when one is advanced in age. Regrettably, we will have to live with the situation for the moment. We hope the government will address this problem in the near future.

If you had elected for any one of the three minimum sum options above, you might want to consider if it is worthwhile switching to CPF Life when it takes effect in September 2009. *(Take a look at Table 3.)*

If you are in the July 2009 cohort of male Singaporeans who turn 55 and meet all the assumptions spelt out in *Table 3*, it might be worthwhile to switch to a CPF Life Plus plan.

Suppose you had elected to leave your full minimum sum of $106,000 with the CPF Board, you will draw down $910 per month for 20 years, after which you will receive no further income. If you elect to switch to the CPF Life Plus plan, you are guaranteed $822 to $900 per month for life. Although there is a slight loss of monthly payout ranging from $10 to $88 a month, it is compensated by the guarantee of an income for life!

A further point to note is your draw down age (DDA), to assess your annuity payout from CPF Life. See chart below:

Born In	DDA
1949 or earlier	62
1950 to 1951	63
1952 to 1953	64
1954 or later	65

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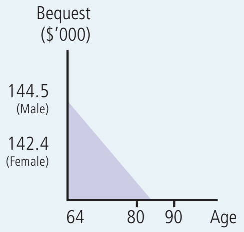
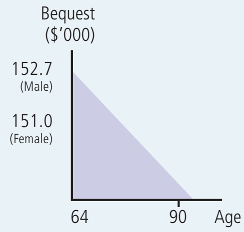
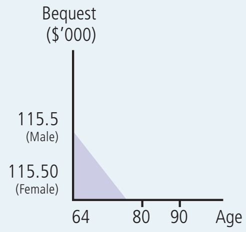
TABLE 3 **CPF Life Payout (Estimated)**

IMPORTANT NOTE: Information and rates are correct at date of print and are subject to changes. *Source: CPF website.*

Plan		Life Balanced	Life Basic	Life Plus	Life Income
Description of the plan		This plan is balanced to pay you a monthly payout for life and what you leave to your benificiaries.	This plan provides a lower monthly payout than LIFE Balanced Plan, but leaves more to your benificiaries.	This plan provides a higher monthly payout than LIFE Balanced Plan but leaves less to your benificiaries.	This non-refundable plan provides the highest monthly payout than the other plans but does not leave anything to your benificiaries.
Monthly payout[1] from 64	Male	$775 to $848	$725 to $795	$822 to $900	$879 to $957
	Female	$721 to $793	$694 to $764	$743 to $817	$768 to $841
Bequest left to your benificiaries[2]		Bequest ($'000) 144.5 (Male) 142.4 (Female) 64 80 90 Age	Bequest ($'000) 152.7 (Male) 151.0 (Female) 64 90 Age	Bequest ($'000) 115.5 (Male) 115.50 (Female) 64 80 90 Age	Nothing will be left to beneficiaries.







NOTES:
1. The above estimated monthly payouts are shown in ranges as the monthly payout that a member receives under CPF LIFE will be adjusted depending on the actual interest rate and mortality experience. Thus, the above ranges do not represent the upper and lower limits of the payouts for the respective plans. The interest rate assumptions used in the above computations vary between 3.75% and 4.25%.
2. The bequest amount includes the estimated RA balance (at interest rate of 4%) and LIFE annuity premium less the monthly payout from the plan. The reduction in the bequest may not be linear over time. The diagram is only for illustrative purposes and is not drawn to scale.
3. Input assumption: Singaporean (Male/Female); Born 07/1953; RA Balance $106,000; Annual Value ≤ $6,000; Assessable Income ≤ $24,000; Qualifies for full L-Bonus $4,000.

PRIVATE ANNUITY PROVIDERS

The pool of annuity providers in the market at the moment is limited to no more than three life insurers and product offerings are fairly limited. They provide a mix of immediate and deferred participating and non-participating annuities, with and without guaranteed return of capital. One insurer also tagged its offering with long-term care benefits. There is also a joint-life annuity option for couples who wish to insure on a last survivor basis.

It must be emphasised that extra benefits that come packaged with your private annuity schemes do eat into your monthly annuity payouts. It may not be to your benefit to purchase these frills with the annuity if you do not need them.

All of the products mentioned serve as useful alternatives to diversify and supplement payouts from CPF Life, and/or whatever lifelong income scheme you have already put in place to meet your retirement needs.

CONCLUSION

As a recap, an annuity is a key cash flow management tool for retirement. An early start is vital as it takes time to accumulate the single payment or series of payments that is needed to fund this crucial retirement tool.

If you are in need of advice to integrate your annuity options with your overall retirement plan, do contact us at First Principal and we will be happy to help you out.

Why not plan early toward a worry-free retirement? It is an option that we all can afford.

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