Source: *The Straits Times*, pA27
Date: 27 February 2015

Tell people how much others are putting aside; let them withdraw a lump sum when they agree to defer payouts – two examples of using behavioural economics to nudge people into saving more.

A few CPF tweaks can help people save more

By DONALD LOW
FOR THE STRAITS TIMES

THE Central Provident Fund Advisory Panel has proposed a number of important enhancements to Singapore's system of compulsory retirement savings for workers.

Putting aside the issue of insufficient balances for older, lower-income Singaporeans – a problem which the panel says may need to be addressed "outside of the CPF system" – the key question is whether the changes would help Singaporeans make better financial decisions for their retirement. In this regard, a number of important findings from behavioural economics should guide the CPF Board in implementing the panel's recommendations.



Saving for retirement is not particularly salient and does not consume much of people's scarce cognitive resources during most of their working lives. The problem arises at 55, when they are suddenly asked to make decisions that critically affect their financial well-being in retirement. ST PHOTO: DANIEL NEO

Saliency and information

THE first thing the CPF Board should bear in mind is that in contrast to its employees, who live and breathe the CPF system, the majority of Singaporeans who rely on the CPF for their retirement security probably do not expend much cognitive effort on it.

For employees, contributions to the CPF are deducted automatically from their salaries. That makes it even less likely that they would pay much attention to how the CPF system would affect their (future) well-being. To the extent they think about the CPF at all, it is usually when they draw from it to pay for their homes.

Like health insurance, saving for retirement is not particularly salient and does not consume much of people's scarce cognitive resources during most of their working lives. But unlike health insurance, nearly all would have to rely on retirement savings and make quite consequential decisions on how these savings should be drawn down to finance their retirement.

So although the lack of saliency of the CPF makes it convenient for them – because they don't have to think and worry too much about retirement savings during their working years – the problem arises at 55, when they are suddenly asked to make decisions that critically affect their financial well-being in retirement. That is daunting and difficult for most people.

Not only are the terms used – annuities, CPF Life premiums, draw-down age (to be replaced now by payout eligibility age and payout start age) – unfamiliar to most people, but it may well be the case that most people lack the skills or knowledge to make good decisions by themselves.

The common response to this problem is to step up financial education and counselling efforts.

This is also what the panel has recommended. But when the financial education is done and how it is done also matter. To explain the new and potentially confusing options to a CPF member who has just turned 55 is probably to leave it until too late, and cause anxiety and stress that could be avoided if the financial education were done earlier and more frequently.

The CPF Board should therefore regularly provide information that guides CPF members to make sensible decisions. For instance, it could consider informing members annually whether, given their current contribution and housing withdrawal patterns, they are likely to meet the Basic, Full or Enhanced Retirement Sums. These correspond to different monthly payouts people will receive in their retirement years.

More radically, it could indicate to members how they are faring in accumulating savings relative to others of the same age.

The CPF Board should also consider how it can take advantage of social proof to discourage people from making lump-sum withdrawals prematurely. For instance, it could inform CPF members turning 55 that the large majority of people leave the bulk of their savings with the CPF rather than withdraw them as soon as they can. The reason for this is that people are very social creatures; in situations that are unfamiliar to them, they take their cue from how others behave.

Setting the right defaults

THE second consideration that the CPF Board has to bear in mind when implementing the panel's recommendations is to set defaults that make sense for different segments of the population.

The panel's recommendations allow Singaporeans greater choice and flexibility over their CPF savings, especially in relation to how much they would set aside for retirement at 55 and when they would like to start receiving their payouts.

No longer would there be a single Minimum Sum that applies to all; this would be replaced by the Basic, Full and Enhanced Retirement Sums – each corresponding to a different payout level.

CPF members would also have the option of delaying their annuities to a later age – after 65 and as late as 70 – and in return, receive higher payouts (of 6 to 7 per cent more for each year of deferral).

While increased choice and flexibility are welcome, they also mean that what the CPF Board sets as the default is extremely important. This is because most people tend to stick with the defaults, whether or not these defaults are the most suitable for them.

For instance, consider what should be the default for CPF members who have enough savings to meet the (highest) Enhanced Retirement Sum. These members would automatically have the Full Retirement Sum set aside in their Retirement Accounts unless they tell the CPF Board that they would like to set aside more. The default setting is the Full Retirement Sum even though these members can afford to set aside more.

But changing the default such that these members would automatically set aside the Enhanced Retirement Sum (unless they indicate otherwise) also has its own problems – chief among which is that most people may prefer to have more available for flexible withdrawals than to have higher monthly payouts.

The best way to find out is to survey CPF members who are likely to be in this group on what their preferences are: to have more for lump-sum withdrawals and less in monthly payouts or less for lump-sum withdrawals and more in monthly payouts. Such an exercise would allow the CPF Board to figure out Singaporeans' preference and set a default that makes sense for the majority of this group.

'Multiple selves' and discounting

THE third consideration is the tendency of most people to "discount" future benefits. Thus, faced with a choice between an immediate reward and a delayed reward that would increase by the market interest rate, people often choose the former. This implies that their discount rate between today and the future is much higher than prevailing interest rates.

Immediate rewards activate our "hot" emotive system and cause us to choose impulsively, often forgoing larger future benefits. This is why most people, left to their own devices, would not save enough for retirement. While people may know they need to save more for the future, the current sacrifices this requires of them often leads to inertia and procrastination ("I'll start saving tomorrow"). This problem is compounded by the fact that many do not see their future selves as belonging to themselves.

One of the panel's best ideas was to give CPF members the option of delaying their payout start date to after 65, up to 70. But the problem is that if a 65-year-old is asked whether he would like $1,000 every month for life starting (more or less) immediately or $1,060 every month for life starting a year later, it is quite likely that he would choose the former.

One way of dealing with this problem of people favouring immediate rewards over future (higher) rewards is to bring forward the decision – by say two years (in this instance, when the CPF member turns 63). When the choice is one over future options, people are more likely to rely on their "cool" reflective system to weigh the options carefully.

Another possibility is to consider giving in a lump sum the higher payouts as a result of delaying the start date. For instance, if delaying the payout by two years increases lifetime payouts by $30,000 (discounted to present value), the member could be given the option of withdrawing part (say half) of this in a lump sum. This increases the attractiveness of delaying the payout start date since most people are drawn to a large lump-sum benefit more than a stream of (slightly) increased monthly benefits.

stopinion@sph.com.sg
The writer is associate dean of research and executive education at the Lee Kuan Yew School of Public Policy, National University of Singapore.

Source: The Straits Times © Singapore Press Holdings Ltd. Permission required for reproduction.