Worry–free retirement savings bonds for the nation and region

MY Say

BY JOSEPH CHERIAN

For most retirees, a secure and sufficient income stream during retirement is the ultimate goal. Traditionally, this is achieved through either a defined benefit (DB) or defined contribution (DC) plan, where contributions made during working years help build a retirement income. While DB plans place the responsibility on institutions, such as governments or private firms, DC plans shift the burden to individuals. Herein lies the challenge — managing retirement funds can be daunting without financial expertise.

DB plans, while simple to understand, are increasingly unsustainable, with many underfunded or in financial distress. Consequently, many DB plans are converting to DC schemes. In a DC plan, individuals accumulate savings over time, which ideally would be converted at retirement into an inflation-indexed life annuity, ensuring a stable income adjusted for cost of living.

Singapore's Central Provident Fund (CPF) is a leading example of a DC system, allowing members to save safely with government-linked interest rates ranging between 2.5% and 6%. At retirement, these savings can be transferred to CPF LIFE, a life annuity. However, CPF LIFE has limitations: it lacks payouts that are inflation-indexed, and members do not have a clear view of their retirement income stream from CPF LIFE during the accumulation phase, unlike the US Social Security system, which provides an annual estimate of future monthly payouts adjusted for inflation throughout the member's lifecycle.

A robust retirement solution would combine the strengths of the CPF and US Social Security, enabling individuals to save with confidence, knowing their income will support their lifestyle in retirement, adjusted for both inflation and even perhaps rising standards of living. This goal could be met through a retirement savings tool that grows with both inflation and an evolving standard of living.

This concept already exists through Retirement Security Bonds (RSBs), developed by Nobel laureate Professor Robert C Merton and Dr A Muralidhar. These bonds function like deferred life annuities, issued by the government, and their face value grows in line with standard-of-living metrics, such as per capita consumption growth. Upon retirement, the RSBs begin paying a regular income, indexed to growth in the standard of living. Individuals can purchase RSBs to match their retirement needs, and as flexible, regulated products, RSBs offer competitive returns and stability.

With RSBs, retirees can tackle inflation while keeping up with a rising standard of living. Periodic statements show expected payouts based on current savings, allowing retirees to adjust contributions if needed. For example, a retiree who has accumulated US$100,000 in RSBs by age 55 could expect to receive US$7,500 per annum starting at age 65, with payouts increasing annually in line with standard-of-living metrics.

In Malaysia, a combination of Kumpulan Wang Persaraan (Diperbadankan) (KWAP), a DB scheme for government servants, and the Employees Provident Fund (EPF), a DC scheme for the rest of us, could achieve a similar result for all. Contribute to the EPF during your working years, which will invest the monies in RSB-like securities that translate into a deferred life annuity paid out by KWAP in your retirement years.

In fact, the Basic Expenses for Decent Living (Perbelanjaan Asas Kehidupan Wajar or PAKW) index, recently introduced by the Statistics Department, could serve as a baseline for indexing RSBs locally. The PAKW, based on data covering 419 essential items, defines the spending required for a household to meet basic needs. By linking RSB payouts to an index derived from PAKW, retirees would see their income adjusted to maintain a decent standard of living, regardless of inflation or other economic shifts.

With adjustments for local requirements, the Merton and Muralidhar RSB approach could make retirement planning a simpler, worry-free process for Malaysians and the wider region. E

Joseph Cherian is deputy CEO at the Asia School of Business

Clarification

Our article "Mr Krishnan will see you" (Forum, Dec 9, 2024) should have said that Petronas chairman Raja Tun Mohar Raja Badiozaman and president and CEO Tun Abdullah Mohd Salleh retired in February 1988, and not as published.