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CPF and what it can be used for

HOW many of us really know the intricacies of our Central Provident Fund (CPF) savings and how best to maximise their use?

CPF savings primarily serve three basic needs: Retirement, home ownership and medical coverage. CPF contributions are split into three separate accounts: Ordinary, Special and Medisave Accounts.

For most CPF members, the Ordinary Account attracts the most contributions and these can be used to buy a home, pay for stock purchases, invest in selected insurance plans and unit trusts and fund children’s education.

Given the wide array of uses, it is imperative to think carefully before using your Ordinary Account savings and to understand fully the implications of each course of action.

The Special Account is primarily focused on providing for retirement, although in January 2001, the Government liberalised its use and allowed funds in this account to be invested in a range of low- to medium-risk financial products.

In the case of the Medisave Account, it can be used for hospitalisation expenses and approved medical insurance plans (eg Medishield-type plans). However, there are limits on how much Medisave funds can be used to pay for these.

Currently, savings in the Ordinary Account earn a guaranteed interest rate of 2.5 per cent per annum, while those in the Special and Medisave Accounts earn 4 per cent per annum. These rates are higher than most deposit rates offered by banks.

Thus far, Singaporeans have ploughed a significant amount of their CPF savings into the property sector. According to statistics from the CPF Board, $110 billion had been withdrawn for property purchases at the end of last year.

Given the weak property prices in the past few years, many property buyers may be suffering from negative equity. This occurs when the borrower is servicing a mortgage greater than the value of his or her property.

For such a property, if the bank has the first charge and if the borrower defaults on loan repayments or decides to sell his or her property, the sale proceeds go towards repaying the outstanding bank loan first. The CPF Board is only paid if there is any money left over.

Hence, CPF members can lose a substantial part of their savings when buying and selling properties. This is one reason why the CPF Board has put in place limits on how much CPF savings can be used to fund property purchases. At present, it is 138 per cent of the property value, but by 2008, it will be reduced to 120 per cent.

Besides properties, a significant amount of CPF savings have also been invested into stocks, insurance plans and unit trusts. The amount withdrawn for investments in these products stood at nearly $29 billion at the end of last year. A further $74 billion was lying idle in the Ordinary and Special Accounts and these could have been used for investments in selected financial products.

Unlike properties, CPF investments into financial products are not leveraged purchases. Nevertheless, they could result in losses or poorer returns than what CPF members would have received had they left their balances idle.

Hence, it is important that CPF members invest their savings wisely — an issue we will examine in greater detail next week.

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Private bankers should target non-local Indians here before venturing into India: Expert

Valerie Law
valerie@newstoday.com.sg

PRIVATE bankers and wealth managers in Singapore should take on as clients non-local Indians based here as a stepping stone to targeting India’s wealthy.

This is because servicing them would give invaluable experience and insights into Indian culture, as well as provide leads to Indian customers when the banks venture into the burgeoning south Asian economy, said Mr Arpit Agarwal during the Private Banking Asia seminar held in Singapore recently.

“Build from the relationships. They have friends and relatives back at home,” said the head of Private Banking for ICICI Bank, the largest private bank in India.

His advice comes following the Comprehensive Economic Cooperation Agreement inked between Singapore and India last month. Bilateral contracts cover tariff reductions, an improved scheme to avoid double taxation, and increased ease of movement by professionals between the two countries, among other things.

Singapore’s three banks — DBS Bank, United Overseas Bank and Oversea-Chinese Banking Corporation — will be allowed to set up a maximum of 15 branches each in India over four years, exceeding India’s current quotas on foreign banks.

Despite uncertainty and cautiousness exhibited by foreign banks due to risk factors involved in making overseas investments, Mr Agarwal is optimistic about the growth of financial services in India.

Given that India has a high savings rate but only a small proportion of which is allocated to financial investments, the outlook for banks looking to offer private banking services is bright.

“There is a 95-per-cent market that is waiting to be tapped and advised,” he said.

When Mr Agarwal set up ICICI bank’s private banking business back in March 2002, he was targeting to be in 22 cities with 55 branches.

But in just two-and-a-half years, it grew to be in 175 cities with over 350 branches offering private banking services.

Because major international banks already have a presence in the key cities of India, some players worry that the banking scene in India is getting too crowded. However, Mr Agarwal noted that foreign banks were still in the customer-acquisition mode, rather than the customer-retention mode seen in mature markets.

“The market is growing so fast, there is room for everyone,” said the private banker with more than 11 years’ experience in the industry.

He suggested that foreign firms who are risk-averse but want a foot into the India market could start small.

For example, they can distribute their financial products via local service providers to non-local Indian clients or the foreign community.

So far, DBS Bank has been the most aggressive of the three Singapore banks in penetrating the Indian market.

Singapore’s largest bank last month acquired a 37.5-per-cent stake in finance company Cholamandalam Investment and Finance, with ambitions to set up bank branches in Chennai, Bangalore, Pune, Kolkata and Hyderabad, to add to its branch in Mumbai.