Guaranteed rates due to GIC pooling of funds

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If the GIC managed CPF funds as a separate pool, and not together with other government assets, the interest rates that the Government has committed to would be unsustainable, Deputy Prime Minister Tharman Shanmugaratnam told Tuesday's CPF forum. Mr Tharman was responding to questions from blogger Roy Ngerng, who is being sued by the Prime Minister for defamation. Mr Ngerng fired off four questions and Mr Tharman, who is also Finance Minister, answered them in turn. Here is an edited transcript of the exchange.

ROY NGERNG: Now that we know that the CPF is invested in the GIC, is it also possible to know what is the interest earned in Singapore dollar terms since inception?

Second, Temasek Holdings has said that it does not invest our CPF. The GIC was set up only in 1981, so prior to 1981, how was the CPF used and was it invested in Temasek Holdings?

Third, how much has the Government earned in absolute monetary terms from the excess returns of the CPF and will the Government consider returning some of them to Singaporeans?

Finally, the GIC has said before June this year that it does not know if it invests our CPF because it is not made explicit to GIC. But in June, the Government admitted that it does. So in the public interest, is it possible to know why the Government made an about-turn?

DPM THARMAN: You asked some factual questions. Did Temasek manage the CPF funds in the past? No. It has never managed CPF funds. Temasek started off with a set of assets which were transferred by the Government at the time of inception - I don't have the exact figure in my head - but about $400 million worth of assets in the form of a set of companies. It has never received CPF monies to invest.

Before we amended the Constitution in 1992, CPF monies, which were invested in Special Singapore Government Securities (SSGS), could be used by the Government to finance infrastructure - such as road infrastructure, Singapore's economic infrastructure and social infrastructure. Just like (other) Singapore Government Securities (SGS), the Government was allowed to use borrowings in addition to the revenues it got in its Budget, to finance infrastructural investments. That was the old system.

That changed in 1992. Together with constitutional amendments, we introduced the new Government Securities Act, which disallowed the Government from using borrowings for spending. From then onwards, all borrowings - the SGS, SSGS - have had to be invested.

How are they invested? Prior to the formation of the GIC, it was the MAS (Monetary Authority of Singapore).

It was an old-fashioned, central bank investment system. Dr Goh (Keng Swee) changed that, explained why, explained that these are basically longer-term assets, and we should invest them for the longer term. And a significant chunk of reserves that were managed by the MAS was passed back to the Government, which then had the GIC manage them.

After the GIC was set up in the early 80s, it was essentially the GIC that managed CPF assets, but not as CPF assets. It is managing government assets: all government assets put together.

GIC knows it is managing government assets. That is the Government's mandate for the GIC. The mandate is irrespective of the source of funds it manages, which comprise the SSGS, the SGS, government surpluses, the proceeds from land sales - all government funds. The GIC (hence) pays no regard to what the source of funds is. It just has to meet its mandate: to invest for the long term, take risks, in the hope of achieving good long-term returns, significantly above global inflation.

And that is a real strength of our system, that besides the CPF, we have unencumbered government assets - government assets that don't have liabilities like the CPF. If the GIC was just managing CPF funds as a CPF fund manager, it would be managed quite differently. To provide a guaranteed interest rate of 4 to 5 per cent of the Special Account, or 2.5 to 3.5 per cent of the Ordinary Account, capital guaranteed and interest rate guaranteed, it would be a very different fund that it would be managing. It would be invested largely in bond securities, and earning returns that are very different from what it is able to earn by investing for the long term in higher-risk assets. Plus, it would mean the interest rates that the Government has committed to would be unsustainable, because it is no longer possible to earn these interest rates on a guaranteed basis, using a bond portfolio. It's very difficult.

So the GIC manages a pool of government assets, irrespective of sources of the funds. It is the Government that then takes the risk. The Government takes the risk that the performance of the GIC from year to year, sometimes even over five-year periods, may not be adequate for it to meet commitments to the CPF.

The strength of the system is we have assets that exceed our liabilities, that enable us to meet our commitments. And that's why we're not just triple-A rated, but we're able to provide CPF members with a very fair return on a guaranteed basis.

Next question had to do with excess returns. The GIC publishes five-year, 10-year, 20-year returns, and they are easily computed into Singapore dollars. Over the last five years it earned 0.5 per cent in Singdollar terms, over the last 10 years it earned 5 per cent in Singdollar terms, over the last 20 years it earned 5 per cent in Singdollar terms. So those are the facts, but that's not returns gained from investing CPF monies. That's returns gained from investing all government assets, including the unencumbered assets. It's returns gained from investing in higher-risk portfolios for the long term. If it was just CPF monies, it will be a different portfolio and a different set of returns. Every serious financial professional knows that.