Financial Services India Pension Reform Needs Assessment

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FINANCIAL SERVICES INDIA PENSION REFORM: NEEDS ASSESSMENT

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1 BACKGROUND

India boasts one of the world's oldest and largest old age income security systems. The current state of pensions in India is the result of individual plans developed and amended over several decades, rather than of a comprehensive and coherent approach to old age income security and social protection, based upon a guiding set of principles. This has resulted in gaps of *coverage* in several areas, and duplication within various programs in other areas, meaning that limited resources are not being targeted to vulnerable segments of the population. Similarly, *income* generated through existing programs is inadequate for many retirees, and often does not provide for protection against the risks of longevity and inflation. Further, due to massive and mounting fiscal liabilities of civil service pension programs in particular, the long-term *financial sustainability* of some pension programs is also threatened, placing an unduly heavy financial burden on the Government. In addition, restrictions on investment options do not facilitate *capital market development and economic growth*. Other problems include the lack of a consistent legal and regulatory framework, poor administration, lack of portability between pension schemes, and fragmentation of responsibilities for oversight and implementation. As a whole, India's various old age income security programs are not achieving the intended objectives of providing adequate old age income, covering needy segments of the population, ensuring financial sustainability, and contributing to economic growth.

At the same time, India is undergoing major demographic shifts, in which the elderly population will double from its 1991 level by 2016. In comparison, it took most Western European countries nearly a hundred years to undergo the same transition, and they did so at a much high level of per capital income than India will.

In addition to providing old age income security, *one of the most important impacts of pension reform in India will be the mobilization of savings for investment in the capital markets.* The current civil service pension program is unfunded. The provident funds and the private sector pension program under EPFO are funded, but the assets must be fully invested in government obligations. In essence, all of these programs are government guaranteed pension schemes financed or subsidized by the government. India's workers are forced to accept lower pensions due to the lower rate of return on government debt than private sector debt and equities.

India's capital markets have been starved of long-term investment capital such as is typically provided by investors – such as pension funds and other institutional investors - with long-term investment goals. *India's companies need access to this long-term capital to modernize and to become more efficient so that they can compete in the global economy.* Countries without long-term capital investment will remain at a severe disadvantage. Thus, both the pension participants and India's progressive companies will be beneficiaries of improved pension schemes and capital markets. The key steps in freeing up these assets for real investments and higher returns are to:

- create funded pension systems for government workers and all private sector employees in the organized and unorganized sectors,
- continue current activities to strengthen and develop capital markets so that suitable investor protections are in place, and

- liberalize pension investment restrictions as appropriate regulatory measures are put in place to protect pensioners from improper investment practices

This assessment deals with options for creating funded pension systems and is consistent with current efforts being undertaken to strengthen capital markets. Once these two steps have been completed, liberalization of investment restrictions will be a logical next step. *It is important to keep in mind, however, that the primary objective of pension reform must be to protect the interests of covered workers. Supporting capital market development is a secondary goal.*

However, before action is taken with respect to pension reform, consensus must be reached among the major policymakers and stakeholders on the way forward. In addition, in order to maximize resources and achieve the desired objectives, activities between providers of assistance must be coordinated. At present, there are numerous players involved in pension reform, including: the Government of India, other Indian private sector organizations, World Bank, Asian Development Bank, Canadian International Development Agency, Department for International Development International Labour Organization, and others.

The Importance of Reforming India's Pension Programs

All too often, pension reform is seen by donors and Governments alike almost as an afterthought, or an adjunct to civil service reform or capital markets development. This approach fails to realize the considerable impact that pension programs typically have on economic development, social equity and poverty alleviation. Following are four reasons why pension and provident fund programs can have a substantial impact on economic and social development:

Use of scarce public funds: The Government of India currently spends almost 15% of its net tax revenues on pension programs, largely for civil servants who earn relatively large incomes and receive generous retirement benefits. While pension programs help to motivate and retain talented staff in the public sector, the *high opportunity cost of this expenditure must be considered*. Could scarce tax revenues be better used to fund targeted poverty alleviation programs, for example, or needed improvements in the country's infrastructure? A funded civil service pension program would reduce the government's fiscal burden and free up tax revenues for other important initiatives.

Allocation of private-sector resources: EPFO manages almost 400 billion Rupee in member contributions. Due to its strict investment guidelines, virtually all of these funds are placed in public-sector securities such as government bonds and debt financing for state-owned enterprises. While EPFO represents a significant source of funding for the Government, its investment patterns *crowd out private investment*. Contributions to EPFO are mandatory, and equal 10-12% of wages. This leave little left over to save in banks or invest in India's capital markets. If EPFO's investment guidelines were liberalized, a vast amount of money could be re-directed towards more efficient investment in the private sector.

Labor market efficiency: EPFO offers little to its members in terms of portability of benefits. If a member changes employers, he must withdrawal his accumulated funds and start over. However, public dissatisfaction with EPFO has led many employees to "escape" the system as soon as they have the opportunity and take pains to avoid re-entering it. In this way, EPFO and related mandatory pension programs could *inhibit the formalization of India's economy*. Similarly, civil service pensions are generally not transferrable from central to state level or across states, and certainly cannot be maintained when one moves from public service to the private sector or vie-versa. This lack of portability *reduces labor market efficiency*, which in turn depresses economic growth.

Poverty alleviation: It is well known that a vast number of Indians already live in poverty and that some 90% of the labor force works in the informal sector. Only around 10% of India's labor force has access to any formal retirement savings vehicle, mandatory or voluntary. *Even those workers who do contribute to EPFO will receive very little in old age income. India's elderly will double as a percent of the total population by 2016* (from 1991 levels). A large number of elderly are likely to fall into grinding poverty over the next decade. While many will receive income support from their families, others will not; and those who do risk becoming a financial burden on their families, reducing their ability to save or spend on other items such as education for the young, healthcare, or microenterprises. An efficient pension or provident fund program that provides adequate retirement benefits can alleviate poverty and thus promote equitable economic development.

1.1 Objectives

Recognizing the importance of these issues, USAID has issued a Task Order focusing on the pension sector. The overall objective of this Task Order is to assist USAID/India to gain a comprehensive understanding of the Indian pension systems and develop a framework for intervention in line with USAID's overall country objectives. This assessment will feed into USAID's five-year development strategy, due to be reviewed in December 2001. This assessment will focus on five key issue areas related to pension reform:

1. Legal, Policy, and Regulatory Framework for Private Pensions
2. Advocacy, Education, and Consumer Protection
3. Training and Research
4. Existing Pension Scheme Reform
5. Civil Service Pension Scheme Reform

1.2 Key Criteria and Conditions for USAID Involvement

USAID is in a unique position to provide resources and technical expertise needed to facilitate successful, appropriate, and lasting reforms to the national pension system due to three factors:

1. USAID's ability to provide substantial amounts of grant (rather than loan) assistance
2. The fact that USAID, unlike most other bilateral and some multilateral donors, an provide in-house expertise in pension reform, and
3. USAID's access to a wide range of external international expertise related to pension reform

However, the key challenge is to determine where potential USAID interventions will be most effective and appropriate. Any interventions by USAID should be based upon the following guiding principles:

- Comparative advantage of USAID vis-à-vis other donors and providers of assistance
- Fit with USAID overall country objectives
- Sustainable, impact-level results of potential assistance
- Thorough understanding of issues and constraints that could affect success of potential interventions
- Presence of 'champion/s' within Indian Government with requisite interest, willingness, and ability to take the lead on reform efforts, and garner support for reform

2 APPROACH

Before detailing our evaluation it is helpful to describe our approach in undertaking the assessment. Based on the tight deadlines and the limited resources available, the Team first reviewed existing materials and discussed issues with interested and involved parties in the US. After reaching India and discussing priorities with USAID staff, we began by delineating the various existing pension programs and identifying the existing gaps in coverage. We then made a quick summary of the scope of the various programs based on a review of available materials and discussions with key players. At the same time we conducted interviews with many of the government officials responsible for operating and overseeing the existing programs, as well as persons from various international and donor organizations involved in planning or carrying out current pension reform activities. Subsequently we met with representatives of the private sector involved or interested in the pension arena, e.g. employer and employee representatives; representatives of the financial, insurance, and mutual fund industries; academics, institutes and NGOs In this context we also met and exchanged information with two USAID teams involved in related activities or assessments. In all of these meetings we were able to substantiate or modify our views gleaned from the written material and gain new insights into problems and planned activities. A complete list of the persons interviewed is attached as Appendix 1.

Based on the above inputs we developed a logical framework and timeframe for activities needed for successful reform of the pension sector based on international experience and the Indian context. Using this as a foundation we projected possible areas where USAID assistance could best be utilized within the context of realistic timeframes, budget, and availability of US expertise. In this context we also considered the existence of potential or likely champions for activities within the Government of India, the relationship of efforts to the work plans of other donors, the likelihood of sustainable progress resulting from the effort, and the relationship of these efforts to other priorities of the Government of India. We included consideration of past USAID successes in other pension reform activities around the world and in the Indian fiscal sector. We also considered the likely impact of any assistance on related USAID priorities.

Following this analysis, we presented a draft set of findings to the USAID mission in Delhi on October 22, 2001, and submitted a written Draft Assessment on October 26, 2001. Based on the feedback from that presentation and on the Draft Assessment, we developed more detailed descriptions of potential areas of assistance. The present report (Final Assessment) details the Team's recommendations, assessed against a common set of screening criteria, and provides a rationale for recommended USAID interventions, expected results, and general cost estimates. It also includes an Implementation Action Plan which details timing and sequencing of recommended interventions.

3 OVERVIEW OF EXISTING PENSION SCHEMES

3.1 Private Sector

Current estimates indicate that there are approximately 400 million workers in India. About 16.5 million are covered by the central or state civil service schemes and the rest are in the private sector. Within the private sector many employees were covered under a government mandated provident fund as early as 1951, the Employee Provident Fund. This provident fund scheme was extended to include a pension portion that subsequently became the current Employee Pension Scheme in 1993. Even though these programs have a long history, the coverage is limited by statute and only an estimated 28 million of the estimated 383.5 million private-sector workers, or about 7%, are covered by these schemes. There are also a myriad of pension related programs covering this same general set of workers known as the formal sector. These programs include Employee State Insurance, Work Injury programs, gratuity payments mandated by government and various other programs developed voluntarily by employers. Chart 1 below provides a brief description of each of the programs and their major attributes.

Chart 1: Summary of Provident Fund/Pension Programs

	Employee Provident Fund (EPF)	Employee Pension Scheme (EPS)	Employee Deposit Linked Insurance (EDLI)	Special Provident Funds
Legal framework				
Laws	Employee Provident Fund & Miscellaneous Act, 1952	Employee Provident Fund & Miscellaneous Act, 1952	EPF Act	Contractual Obligations
Characteristics of system				
Requirements	• Mandatory for 177 covered industries with +20 employees • Voluntary for other industries and for other firms with <20 employees	• Mandatory for 177 covered industries with +20 employees • Voluntary for other industries and for other firms with <20 employees	• Mandatory for 177 covered industries with +20 employees • Voluntary for other industries and for other firms with <20 employees	• Mandatory for workers in particular sectors: coal mines, tea plantations, Jammu and Kashmir, Seamen, etc.
Coverage	• Firms with +20 employees • About 5.8% of labor force, or 24 million of 40 million formal sector workers	• Firms with +20 employees • About 5.8% of labor force, or 24 million of 40 million formal sector workers	• Firms with +20 employees • About 5.8% of labor force, or 24 million of 40 million formal sector workers	• About 0.5% labor force

	Employee Provident Fund (EPF)	Employee Pension Scheme (EPS)	Employee Deposit Linked Insurance (EDLI)	Special Provident Funds
Nature	• Defined contribution, paid as lump sum upon retirement, resignation, retrenchment, or death • May make periodic withdrawals for education, marriage, home purchase, medical treatment, temporary unemployment	• Defined benefit/PAYG • Paid on monthly basis for super-annuation pension, retirement, disablement, widow/widower, children, orphan	• Lump sum benefit payable upon death	• In the nature of Employee Provident Fund and Employee Pension Scheme
Funding	• Funded • Employer: 1.67 – 3.67% • Employee: 10 – 12% • Government: None	• Partially Funded • Employer: 8.33% • Employee: None • Government: 1.16%	• Employer: 0.5% • Employee: None • Government: None	• Funded • Employer and Employee – 10% each
Risk covered	• Retirement, resignation, death	• Retirement, disability, survivor pension	• Death	• Retirement, resignation, death
Administering institution	• Employee Provident Fund Organization (EPFO)	• EPFO	• EPFO	• Respective Departments Institutions.
Entitlement conditions				
Retirement age	• 58 (may obtain early pension from age 50, but amount of benefit is reduced by 3% per year for every year of shortfall)	• 58 (may obtain early pension from age 50, but amount of benefit is reduced by 3% per year for every year of shortfall)	• 58 (may obtain early pension from age 50, but amount of benefit is reduced by 3% per year for every year of shortfall)	• N/A
Minimum years of service	• None	• 10 years	• None	• None
Pension/PF formula				
Formula	• Accumulation plus interest earned	• (avg. of final year salary x years of service)/ 70	• Average balance in EPF account for 12 months preceding death	• Accumulation plus interest earned
Maximum pension	• N/A	• Rs. 3000 pm	• Rs. 60,000	• N/A
Minimum pension	• N/A	• Rs. 500 pm	• N/A	• N/A
Indexation	• None	• None	• None	• None

Programs to assist the 355.5 million so-called informal sector workers have been more recent and seem to cover a very small percentage of the population. The National Old Age Social Assistance Program was created in 1995 to provide benefits for the aged poor (defined as poor persons over age 65). The program provides for Rs. 75* per month and is supplemented by some states up to a level of Rs.300 per month. There are questions about the reach and effectiveness of this program; however, we did not try to explore this issue since it is beyond the scope of our mandate and very little data exists for evaluation purposes. Although in theory the

Public Provident Fund is available to these workers, in fact the scheme seems to be used almost entirely by higher-income self employed persons. These persons use it mainly for the tax break it affords. Chart 2 provides a description of the fundamentals of the Public Provident Fund and other voluntary pension schemes.

Chart 2: Summary of PPF and Other Voluntary Pension Schemes

	Public Provident Fund (PPF)	Individual and Group Annuity Plans
Laws	• PPF Act, 1968	• Insurance Act • Life Insurance Corporation Act
Requirements	• Voluntary for self-employed and other informal sector workers. • Loans may be taken after 3 years, and withdrawals of 50% of balance may be taken after 4 years, and account may be closed after 15 years	• Voluntary for any individual, Company.
Coverage	• About 0.6% of labor force	• About 0.2% of labor force
Nature	• Provident fund with tax preferences	• Annuity, includes tax preferences
Funding	• Individual contributions	• Individual contributions
Risk covered	• Any	• Any
Administering institution	• State Bank of India/Postal System	• Life Insurance Company of India (LIC) and respective Trusts

* As of the time of the writing of this report (October 22, 2001) the RS/$ exchange rate was 47.

3.2 Civil Service

All employees of the central government are covered by a government sponsored pension scheme. This scheme is an unfunded defined benefit scheme that offers pensions for super annuity, voluntary retirement, death or disablement. Pension payments are a part of current government budgets. There are an estimated 4.5 million workers covered by this scheme.

Although there is not a requirement to do so, the state governments have almost totally adopted the central government pension scheme for state civil servants. The only significant difference is that unfunded pension payments are made from current state budgets rather than the central budget. The best estimate available to us is that about 12 million workers are covered under state pension schemes. Chart 3 below provides a brief description of the Civil Service Pension scheme and Government Provident Fund (GPF).

Chart 3: Summary of Pension Schemes for Civil Service

	Civil Service Pension Scheme	Government Provident Fund (GPF)
Laws	• Enabling Provisions in the Indian Constitution. No Specific Laws	• Enabling Provisions in the Indian Constitution. No Specific Laws
Requirements	• Mandatory for civil servants at state and central government levels	• Mandatory for civil servants at state and central government levels
Coverage	• About 3.5% of labor force	
Nature	• Non-contributory, defined benefit/PAYGO	• Defined contribution
Funding	• Central or state government	• Employee: 6 - 8.33%

	Civil Service Pension Scheme	Government Provident Fund (GPF)
Risk covered	• Retirement, Disability, Family	• Retirement, Disability, Family
Administering institution	• Respective Departments/Ministry	• Respective Departments/Ministry
Retirement age	• 60	• 60
Minimum years of service	• 20 years but partial payment after 10 years of service, and maximum years taken into account is 33.	• N/A
Formula	• Final 10 months salary x (1.5% x years of service)	• No formula, based upon contributions
Maximum pension	• 50% of salary last drawn	• N/A – depends upon accumulation of contributions
Minimum pension		• N/A
Indexation	• Full to Inflation and Wage increases through revisions recommended by Pay commission once every 10 years	• None

3.3 Summary Assessment

Regardless of level of development or geographic location, all countries must consider some common, basic factors when designing programs to ensure old age income security for its citizens. Any national pension system should strive to achieve four basic objectives:

1. Provide adequate old age *income* to individuals participating in the system as well as insurance against common risks
2. Extend *coverage* of the system to as large a group as financially practical, focusing resources on needy segments of the population
3. Ensure long-term *financial sustainability* of the system
4. Support *economic growth* and stability through the pension system

Taken together, India's various pension and old age income support programs represent a patchwork "national pensions system". Overall, this system falls far short of the above-stated four objectives, as summarized in the following table.

Summary Assessment of India's Pension Programs
Objective 1: Adequate Old Age Income and Insurance Against Risks
• Old age income for most EPFO-covered workers is low, due to a high level of withdrawals and generous commutation allowances • EPFO programs do not insure against risks of longevity and inflation • Incomes for retiring civil servants are higher, but at the expense of other public expenditures since pensions are paid from central and state budgets – and pension liabilities will rise in the coming years
Objective 2: Broad and Appropriate Coverage
• Only around 10% of the total labor force is covered by any formal pension program – virtually all of the vast informal sector is completely uncovered • Some formal private sector workers "fall through the cracks" due to statutory limitations on EPFO coverage and EPFO's poor compliance enforcement capabilities

Summary Assessment of India's Pension Programs
Objective 3: Financial Sustainability
• EPF is "sustainable" by definition because it is a contributory provident fund; however, rates of return are fixed and must be paid by the Gov't regardless of actual performance of investments, which creates an implicit liability • Due to mounting and massive unfounded liabilities, civil service programs appear to be unsustainable and will increasingly reduce state and central governments' ability to provide other important public services
Objective 4: Positive Economic Impact
• EPF and other funds represent a vast amount of resources that must be investment solely in government instruments; this investment pattern crowds out private investment • Unfunded government pension schemes take money away from other valuable public investments • Both EPF and civil service schemes provide very limited portability, which reduces labor mobility and thus, overall economic efficiency

4 EXISTING PENSION SCHEME REFORM

4.1 Government of India (GOI)

There are several efforts presently being pursued by the Government of India in the area of pension reform, detailed below:

1. *Civil Service:* The Minister of Finance (MOF) committed in his budgetary speech to establishing a new funded pension scheme for all civil servants of the Central government hired after September 30, 2001. A task force was created under the direction of a highly respected recently retired civil servant. This task force is due to submit their report to the MOF within the month of October. Based on our discussions with the members of the task force, the report will likely describe the problem and list some of the assistance necessary to develop the promised program. There will not be a recommendation of a specific program at this time.

   In regard to state civil servant schemes at least two states have announced their intention to reform their unfunded civil service schemes. However, there have been no specific plans developed. The World Bank sponsored activity listed under Section 4.2 may begin to analyze this area.

2. *Private Sector-Formal:* The existing schemes for the formal sector operate under the Employee Provident Fund Organization (EPFO). The EPFO has undertaken some internal reviews and recently received a report from the Asian Development Bank recommending certain restructuring of the organization and modernization of software and hardware. The EPFO has contracted with its own funds the services of Siemens Co. to implement a restructuring of its work processes and to develop new plans for software and hardware. This contract <u>includes development of a plan to initiate the structure for issuing unique identification numbers to all 28 million EPFO members. The issuance of this unique identifier is key to any and all pension reforms in the country since no current identifier exists.</u> It should be noted that the benefits of creating a unique ID number for EPFO contributors can be shared across a number of agencies, including the tax revenue authority and agencies concerned with demographic forecasting, etc. Therefore, as the initiative moves forward, it might make sense to develop a cross-agency task force to oversee the progress of the initiative and contribute towards it. EPFO also has developed plans to train its managers in team building, change management, and customer relations and to train substantial numbers of staff in the IT area. For these latter areas EPFO has contracted with the Indian Institute of Management (IIM).

3. *Private Sector- Informal:* In 1999, the Minister of Social Justice commissioned a group to analyze the possibility of creating a program for the 90% of Indian workers who fall into the informal sector. The result was the creation of the Old Age Social and Income Security (OASIS) Report. This report was circulated within the various government ministries early this year. In the spring of 2001, the GOI tasked the Insurance Regulatory and Development Authority (IRDA) with the assignment of developing a report discussing the possibilities of implementing this OASIS Report or a similar effort. The IRDA Chairman has indicated that he will forward a report to the GOI within the month of October 2001.

OASIS at a Glance

The focus of the Project OASIS Committee is people who currently do not have access to any type of pension programs. The challenge is to establish an institutional infrastructure to enable pension contributions from a large mass of people however and wherever employed with built-in flexibility and ease of access. The principal features of a new pension system as recommended by the OASIS Committee include:

- Portable Individual Retirement Accounts (IRA) with unique number;
- Service delivery from post offices, bank branches, Depository Participant Offices, etc. through "Points of Presence" (PoP) by harnessing technology intensive solutions;
- Centralization of record-keeping and individual transactions through a Centralized Depository;
- Ability for participants to not only choose the fund managers but also the "schemes" offered by such fund managers; and
- Ability for participants to choose annuity providers.

The Committee recommended the following changes to existing EPS:

- Standardization of benefits based on a single contribution rate;
- Professional fund management with necessary relaxation of current investment guidelines;
- Outsourcing of asset management to professional fund managers and benefit provision to professional annuity providers.

4. *Pension Reform Task Force:* In November 2000, the Minister of Finance designated a Pension Reform Coordinator within the Ministry to consider the holistic effect of the myriad of activities and proposals in the area of pensions and pension reform. This Coordinator has established a work group or task force that includes those persons responsible for regulating and operating existing pension schemes as well as others who have a vital interest in the area. Although this team has had a limited number of meetings thus far, we have been told that a charter further defining their responsibilities and activities is forthcoming. The Coordinator has informed us that the report from the Civil Service task force and the report from the IRDA regarding implementation of OASIS will be used as a basis for developing the agenda of the work group. He has also designated a very capable senior staff member to oversee this effort.

4.2 World Bank

The World Bank has indicated interest in working in the area of pension reform in India. Thus far they have produced several papers regarding this issue and have provided technical assistance in the form of training of staff from both the central and state governments in the use of its PROST Model for forecasting pension costs. They have also included pension reform in the agenda for their Structural Adjustment Loans in the four states where these efforts have begun. (West Bengal, Orissa, Madra Pradesh, and Andra Pradesh)

The World Bank has also scheduled an Indian Pension Reform Conference for early December this year in Delhi. Invitees to this 3-day event will be about 200 policy makers from the GOI and related institutions. Papers have been commissioned and topics will include the whole gamut of pension reform issues as well as selected descriptions of results of reform efforts in other countries. Further efforts by the WB will depend on the response of GOI to this conference and subsequent negotiations regarding adjustment loan operations. However, they have committed to establishing a fund to further support research in this area and are considering the assignment of a full time resident pension specialist in India.

4.3 Asian Development Bank (ADB)

In May of 2000, the ADB commissioned a study of the pension system in India. This study included a review of operations and service delivery in the existing EPFO, consideration of the creation of a pension research institute, and development of a recommended framework for pension reform in India. The first part of this study was completed and implementation of many of the recommendations is underway in the activities described in Section 4.1 above. The study for the second and third areas is complete and the report is expected by the end of November.

The ADB has also commissioned a noted academic in this area to write a paper on pension reform in India. Dr. Mukul Asher is in the process of completing this work and it should be issued by the time of the World Bank pension conference in December. Further work by the ADB in this area is contingent on interest by the GOI in further grants or loans.

4.4 Department for International Development (DFID)

DFID is currently participating in and co-financing with the World Bank Structural Adjustment loans for four Indian states (see Section 4.2 above). Pension costs account for a significant and growing share of deficits in most states. Therefore, pensions have been included as one of the issues to be examined in the structural adjustment operations. Since the projects are just beginning, the scope of the effort in pensions is yet to be determined. DFID has no other immediate plans for involvement in the pension sector.

4.5 Canadian International Development Agency (CIDA)

CIDA has a Private Sector Development Project in progress. This project focuses on the financial, telecom, and energy sectors and is comprised of 28 initiatives. Agri-team Canada and JPS Associates are joint coordinators for the one project that involves the pension sector. This is a six-month project scheduled to end in March 2002. The project will result in a draft regulatory framework for the pension sector and will include descriptions of related international experience. The project will also include a seminar in the January/February timeframe. CIDA has no other immediate plans for work in the pension sector.

4.6 International Labor Organization (ILO)

The ILO has an active office in Delhi and has participated in policy and operations studies of the social security sector (including pensions) in the past. For example, in 1998, the ILO conducted a review of the effectiveness of the EPFO programs and suggested some possible methods for improvement and extending coverage. They have no current plans for projects in the pension reform area in India.

4.7 Private Sector Initiatives

In addition to the initiatives listed above, several private sector bodies have undertaken initiatives or established task forces in the pension area. These organizations include the Association of Mutual Funds in India (AMFI), the Federation of Indian Chambers of Commerce and Industry (FICCI), the International Institute of Management (IIM) Bangalore, and the Social Security Association of India.

5 NEEDS ASSESSMENT

5.1 Legal, Policy, and Regulatory Framework for Private Pension System

5.1.1 Indian Private Pension System – a Policy Perspective

India did not have a pension system for the private sector until as late as 1971 when, in a very limited way, a family pension scheme was launched. While the policy makers recognized the need to provide an old age pension and survivors pension as far back as the 1950s, in view of the then prevailing economic and industrial circumstances, they preferred to begin with a "Provident Fund". Thus was enacted the Employees Provident Funds and Miscellaneous Act 1952, that provides for retirement benefits in the form of an Employee Provident Fund ("EPF") to industrial workers and employees of other establishments covered by the Act. This act provided for constitution of a Provident Fund Scheme, to which an employee contributes with a matching contribution from the employer. Coverage is limited by statute to 177 industries, which excludes certain key service industries such as hotels, professional services, etc. Currently, this contribution rate is 10% for a certain category of workers and 12% for others.

Overview of Private Pension Plans

A. Mandatory

- *Employees Pension Scheme 1995*
- *Occupational plans for Army, Coal Miners, Seamen*
- *Unit Trust of India (UTI), Banks, IDBI Pension Plans*

B. Voluntary

- *Public Provident Fund*
- *Annuity Products offered by LIC*
- *UTI Pension Plan*
- *Pension Plans set up large private corporate enterprises for all their employees.*

The Family Pension Scheme of 1971, launched to provide a minimum pension to surviving members, did not yield the results that were expected due to a variety of reasons. In 1993, based upon a report from the tripartite committee set up in 1990, a Presidential Ordinance was promulgated enabling the Government to frame a Pension Scheme covering all workers/employers to whom the EPF Act applied. The EPS came into effect in November 1995, and the Employees Provident Funds and Miscellaneous Provisions (Amendment) Bill was passed by the Parliament in 1996.

Employee Pension Scheme of 1995

EPS is an occupational, defined contribution-cum-defined benefit scheme that provides monthly benefits to employees for super-annuation/retirement, disability, widow/widower pensions and children's pension. 8.33% of employers' contributions to EPF is diverted to EPS, and the Government contributes another 1.16%.

- Covers 177 industries, including establishments with 20 or more employees with a salary of Rs. 6500 per month or less.
- Current coverage is estimated at 28 million workers, or less than 10% of the total private sector labor force.
- Pension amounts are based on final year's salary and total years of service, with a maximum target replacement rate of 50%.

The EPS does not cover about 90% of the labor force, most of which is employed in the unorganized sector. This population continues to be uncovered for any type of pension program *even today*. Only a handful of the industrial and other establishments have voluntarily set up pension schemes. Information about these schemes is sparse or non-existent.

5.1.2 Legal, Regulatory and Supervisory Framework – Private Pension System

There is no single, comprehensive and all pervasive Pension Act in India. Nor is there a Pension Authority as a Regulator. In all cases, the administrators of plans are also their regulators and supervisors. However, under the Insurance Act 1938, Pension Contracts are deemed to be part of the life insurance business. The following table illustrates the prevailing regulatory machinery.

LEGALLY MANDATED PENSION PLANS

S.No	Pension Plans	Regulatory System		
		Legislation	*Regulatory Body*	*Administrator of Plans*
1	Employee Pension Scheme, 1995	EPF Act 1952	Employee Provident Fund Organization (EPFO)	EPFO

VOLUNTARY PENSION PLANS

S.No	Pension Plans	Regulatory System		
		Legislation	*Regulatory Body*	*Administrator of Plans*
1	Public Provident Fund	Public Provident Fund Act, 1968	None	State Bank of India and other Designated Banks
2	Pension Plans of Life Insurance Corporation of India	Life Insurance Corporation Act, 1956	Earlier LIC, now IRDA by virtue of it's authority over Insurance Companies	Life Insurance Corporation of India
3	Pension Schemes launched by Mutual Fund Companies	Mutual Fund Regulations of Securities Exchange Board of India	Securities Exchange Board of India (SEBI)	Mutual Fund Companies
4	Pension Plans of Large Private Companies	Indian Trust Act and Indian Income Tax Act	None (The Trust Act Specifies investment guidelines but enforcement is by state authorities)	Board of Trustees of the respective plans.

5.1.3 Coverage, Portability, Funding, and Income of Pension Plans

Coverage: There are no firm estimates of exact coverage of all these pension plans. The Employee Provident Fund Organisation (EPFO) has estimated its coverage at around 28 million private sector workers, out of the estimated 400 million total workers in the labor force (including civil servants). Various other studies and committees have put total coverage at around 10 - 11%, leaving 90% of the work force uncovered by any sort of pensions plan –be it mandatory or voluntary. This 90% of the work force that is uncovered includes a large number of self employed, unincorporated enterprises in services, trade, transportation, hotel and restaurants, construction and other sectors, casual workers in agriculture, and other fields of the economy (collectively termed as the "unorganized" sector). Further, due to the public's lack of confidence in EPFO's ability to efficiently manage programs and provide good customer service, many potential customers opt out of participation in EPFO's programs. Therefore, in addition to low levels of *target* coverage of the Indian workforce as a whole, *actual* coverage within EPFO is also low (i.e., EPFO actually covers fewer persons than it is meant to cover).

Portability: The existing system does not afford portability, either across sectors, or across schemes within a particular sector. Workers covered by EPFO programs are issued an identification number by their employer, linked to the particular employer. Therefore, each time a worker changes jobs, he/she receives a new identification number from his/her new employer, and must start anew to accumulate his/her pension.

Investments: Existing investments of pension funds are directed and regulations severely restrict investments of pension funds to "safe and sound" assets (mainly government paper), thereby limiting the return potential for the consumer. This limits the accumulation of the fund. As several of these schemes are Defined Benefit plans, this could leave a large unfunded liability to be covered by the Government for EPFO administered schemes, and respective employers for corporate pension plans.

Income: Overall, existing programs usually do not provide adequate income to support retirees. These programs do not provide indexation, therefore, there is no protection for retirees against the risks of longevity and inflation. Further, patterns of frequent withdrawals under the EPF program for non-retirement purposes (i.e., marriage, housing, education, etc.) result in lower levels of income available at retirement

5.1.4 Gap Analysis in the Private Pension System in India

S No	Issue	Gaps
1	Legislation/Regulation/ Supervision	• No Comprehensive Legislation • Regulation is distributed • In all cases, the Sponsor is also the administrator, and supervises the Investment Manager. • The existing pension system is not appropriately integrated into financial markets and development of a private pension system would need to be supported by strengthening of financial markets that can only enable pension funds to achieve their financial goals.
2	Coverage	• Actual and target coverage is low: covers only 6% to 7% of the total labour workforce • Coverage is limited to organized (or formal) sector employees • For many others in the informal sector, especially high-income white collared workers, voluntary participation is motivated by advantageous tax regulations.
3	Product Design	• Bundled Products – i.e. accumulation and distribution are bundled. Given the Indian environment, a need is being expressed in several forums for unbundling the products.
4	Investment Management	• Investments are restricted to sovereign and public sector bonds. • No investment in private sector securities is allowed. • These restrictions will have to be progressively altered to improve the rate of return.

S No	Issue	Gaps
5	Administration	• No unique identifiers exist as to date, though the EPFO has undertaken very recently a project to issue unique identification numbers to its members. *The pension system cannot effectively cover a large segment and be efficiently administered if the exercise is not undertaken at a national level.* • Collection of data that is reliable and accurate, and record management necessary for actuarial analysis, MIS, etc., was found to be non-existent.
6	Tax Issues	• The prevailing tax issues address different sets of priorities, which are frequently changed. • There is a need to review the existing tax system for contractual savings and rationalize the concessions/exemptions to boost private pension products as well as enable growth in long-term savings.
7	Income	• Overall, income from programs is usually insufficient to adequately support retirees • Existing programs do not insure against inflation or longevity (i.e. no indexation) • Low replacement rates due to frequent withdrawals under EPF program

5.1.5 Reform Initiatives Underway

Though there is a recognition that State support, in whatever format and shape, is essential for those segments of the population which cannot afford contractual savings, the increasing burden on Union and State budgets and the economic need in the light of improved life expectancy, the perceived decline in family support systems, and increased aspirations and life style after retirement have all provided an impetus for the reforms in the private pension system through an enabling regulatory and administrative framework.

In the private sector, several task forces/committees were formed to examine existing problems and find suitable initiatives. These include Project OASIS, task forces at FICCI, IRDA and AMFI. Principally, the task forces and committees have focused on the following overwhelming issues, viz.,

- Coverage of all workers, organized and unorganized sector;
- Investment management including, relaxed investment guidelines, modern practices, etc.,
- Creating a suitable environment to achieve the goals in medium and long term.

The Reforms in the private sector attempt to cover:

- Reforms at EPFO for the EPF and EPS aiming at increasing coverage, improving enforcement and supervision, and improving service levels;
- Design of new voluntary schemes for unorganized as well as those not adequately covered in the organized sector, an OASIS product.

5.1.6 Technical and Capacity Building Issues in Reform

Following is a brief list of key tasks to be accomplished if the process of comprehensive and lasting pension reform is to take root:

- **Develop a suitable legislative and regulatory framework:** The Constitution of India contains a provision (Entry No. 24 of the concurrent list under the Seventh Schedule) for formulating legislation on matters inter-alia on provident funds, invalidity, old age pensions, etc. It was in this context that the Employee Provident Funds and Miscellaneous Act of 1952 was enacted by the Parliament to provide, initially for the Employee Provident Fund, and later, through necessary amendments, pension schemes. This enabling environment may be utilized to enact a suitable legislation and form a regulatory authority to enable voluntary savings in pension funds, their regulation and administration. Our discussions with a cross section of people suggest appropriate changes need to be carried out for the existing EPF Act for a comprehensive reform of pensions in the organized sector. Similarly, changes to tax laws need to be carried out to rationalize the tax concessions on long-term saving products such as pension funds.

Questions for the new initiatives:

- Defined Benefit vs. Defined Contribution
- Flat Income vs. Indexed Pension
- Full or Partial funding
- Indexing
- Extent of Investment liberalization
- Guarantee of minimum level of income
- Target replacement rate

- **Identify who will be charged with regulation and build adequate capacity within the office of the regulator:** This is of paramount importance for a private pension system to deliver the results expected of such system.

- **Design a new fund-based system to extend coverage and synchronize with changing socio-economic needs:** A new comprehensive funded pension scheme based upon modern methods of actuarial analysis with private sector investment mangers participation and better asset allocation avenues and appropriate delivery system need to be put in place.

- **Design and implement a massive consumer education campaign** to help consumers understand the ability of pension products to provide for old age income security.

- **Build a realistic database** that will help in product design, pricing and benefit packaging.

5.1.7 Possible Technical Assistance for the Pension Regulator

Issue	Technical Assistance (TA)	Training	Comments
Licensing norms for intermediaries	X		• IRDA can use significant TA here and the agency has indicated that it is very willing to utilize such assistance. • IRDA has written norms for the insurance industry, but does not currently have the expertise to write pension norms. • Self Regulatory Organizations (SROs) for the pension intermediaries must also be formed under the Regulator's guidelines and supervision.
Prudential regulations	X		• IRDA also needs assistance writing prudential regulations, specifically to understand how to produce regulations that will protect the growth of transparent pension coverage without hindering company development.
Monitoring and supervision guidelines	X		• The agency also needs technical assistance to establish appropriate guidelines for monitoring the pension intermediates including the interpretation of the reports received. The expert should counsel the agency on issues regarding the frequency and depth of intermediary review and coordinate these reviews with other regulatory agencies.
Investment guidelines, management, supervision, and oversight	X	X	• The regulator needs both TA and Training to enhance understanding of key investment concepts such as risk, diversification and valuation in order to oversee asset management properly. • Since the pension program participants will be assuming investment risk, regulators must have a strong understanding of these concepts. • Customers need some protections to assure that their assets are not placed with excessive risk.
Solvency and risk management	X		• Once the pension legislation has been written and the nature of the obligations placed on the asset managers have been determined, the regulator may need to make determinations of manager solvency and risk structure. If so, regulations concerning capital adequacy and liquidity will need to be developed and supervised. TA will be very helpful for those creating these regulations.
Human resources planning and development	X		• If IRDA is charged with regulating the pension industry, the agency should create a new division to focus solely on pensions. • In order to complete successfully such a major undertaking, the agency should create an expansion plan, hire a significant number of new professionals and clerical people, and establish necessary management structure. Some TA will be very useful at this stage. • The agency should also create a staff development program to assure that capabilities expand in line with the added responsibilities.
Organizational and management structure	X		• See comments on human resources above.

Issue	Technical Assistance (TA)	Training	Comments
MIS/IT needs, design and implementation planning	X		• The MIS/IT group at the agency will need guidance regarding pension regulation requirements. The staff appears to be quite competent to do its own development work, but they need clear statements of the processes and reports. TA will be most helpful for designing the MIS/IT effort.
Licensing, testing and certification guidelines	X		• TA should assist the regulator to adopt international best practices for establishing these guidelines. There are many excellent programs that industry participants can use for test based licensing to determine competency. Self Regulating Organizations can be very active in this area and they should receive similar TA.
Corporate governance-disclosure investor relations, shareholder protection, compliance, information dissemination, dispute resolution	X		• This topic refers to the pension asset investments in private companies. The Securities and Exchange Board of India (SEBI) should take the lead here since it relates to standards for company trading. TA can provide the regulator with sufficient understanding of these topics to determine that SEBI is performing the tasks appropriately.
Coordination of regulations with banking and capital market regulators	X		• Regulations must be harmonized to avoid conflict and lack of coverage if certain topics are not addressed by any of the regulators. • TA will assist in reviewing the whole structure of financial services regulation.
Self regulatory (SRO) development and practices	X		• Knowledge of best practice procedures will enable the regulator to monitor SRO development in a proactive manner.
Legislation and other legal requirements	X		• If the prospective regulator will participate in writing the enabling legislation, some TA expertise will be very helpful. However, we are not sure that the final regulator will assist in the preparation of the pension legislation. If there is an on-site TA expert, the expert could help the regulator to comment on proposed legislation.
Enforcement mechanisms	X	X	• Enforcement mechanisms must be established for regulation to work effectively. The creation of these mechanisms will encompass training of agency hearing examiners and members of the judiciary who will be reviewing appeals from the enforcement process. • TA should also assist the regulator in the appropriate establishment of the process.

5.1.8 Possible Technical Assistance and Capacity Building

The following Technical Assistance and Training programs should be considered based on our review:

A pension legal and regulatory expert should be brought in to work with the regulator in the following areas:

- Licensing norms for intermediaries
- Prudential regulations
- Monitoring and supervision guidelines
- Human resources planning and development
- Organizational and management structure
- Licensing, testing and certification guidelines
- Coordination of regulations with other financial services regulators
- SRO development and practices
- Legislation and other legal requirements
- Enforcement mechanisms

An asset management expert can provide assistance in these areas:
- Investment guidelines, management, supervision and oversight
- Solvency and risk management
- Corporate governance

The asset management expert will also be able to provide practical advice in these areas:
- Licensing norms for intermediaries
- Prudential regulations
- Licensing, testing and certification guidelines
- Coordination of regulations with other financial services regulators

An MIS/IT expert with heavy pension experience should provide support on the MIS/IT issues.

The technical assistance providers should work with the regulatory agency to determine who should benefit the most from the advice. Generally, the provider should work closely with the senior members of the agency on setting policy, and with the middle level members on the implementation of policies. Since the pension regulator will need to be established from square one, the exact nature of the agency's needs cannot be determined at this time.

The relevant expert should provide the training. Both the Investment Guidelines and the Enforcement Mechanism training programs should be well structured with a classroom setting, but including workshops and team projects to build confidence. The enforcement program should also benefit from external training to illustrate best practices.

5.1.9 Regulatory Options: Single vs. Multiple Regulators

India currently has no pension regulation so there is not a legacy issue. IRDA is a new authority and is currently in a start-up mode. The authority does not presently have the personnel resources to add pension regulation to its responsibilities. Thus, if it were to take on pension issues, IRDA would need to create a completely new department. The effort would not be significantly different from creating an independent pension authority. In either case, legislation would be required to establish the regulatory regime. Most of the officials we interviewed preferred the multiple regulator model.

The major argument for different regulators is that pensions are fundamentally different from life insurance. Life insurance represents an obligation to pay a fixed amount of money under contractual conditions. The issuer of life insurance assumes the portfolio risk of investing the accumulated premiums to generate a return sufficient to pay the claims. Whether or not the investment return is consistent with the terms of the insurance policy, the insurance company must pay the benefit or go into default.

Single vs. Multiple Regulators

Advantages of Single Regulator:

- Can generate economies of scale and scope in supervision; in addition, expertise in similar areas (actuarial analysis) is pooled
- Offers one-stop-shopping for authorizations of conglomerate financial groups and eliminates confusion over who exercises lead supervision and final control
- Unnecessary overlaps are avoided and support services such as personnel, administration and documentation can be merged
- Countries with single regulators (regulation of banks, insurance companies, NBFIs, pensions, etc): Australia, Canada, Denmark, Hungary, Mexico, UK

Advantages of Multiple Regulators :

- Different regulatory areas require need for specialized experts --- very distinct skills are needed from regulators
- Clearer focus on sector under supervision
- Countries with multiple regulators: USA, Germany, Japan

On the other hand, defined contribution pensions are quite different. During their accumulation phase, defined contribution plans are essentially investment products. The asset manager endeavors to earn a sufficient return for the plan participant, but there are no guarantees that the investment will be able to generate a specified pension. Asset managers' capital is not at risk for poor performance. In most jurisdictions, asset managers are prescribed by law and/or regulation from promising specific results. As a result of this fundamental difference, most countries separate pension and life insurance regulation.

At retirement, generally, the pensioner should be able to decide whether to take a lump sum payment of his/her account balance and purchase an annuity, or to leave the money in the accumulation fund and have a specific amount paid each month. If the pensioner determines that the accumulation fund is likely to earn a higher return than the implicit return from the annuity, the choice will be to leave the money in the account. When pensioners decide to buy an annuity, then regulation of their interests rightly falls under the purview of the insurance regulator. Until that point, the regulatory issues are essentially asset management matters and should remain under the guidance of the pension regulator. The competition with asset management companies will likely encourage life insurance companies to offer more competitive annuity rates.

We strongly recommend that India adopt the independent pension regulator model. The regulator should be an authority under the Ministry of Finance with the responsibility for regulating pension and provident funds in the following areas:

- Licensing and overseeing asset managers to manage pension and provident funds,

- Licensing and overseeing major banks to act as custodians for the pension and provident funds,
- Compiling, auditing, and publicizing pension fund investment returns and risk profiles,
- Reviewing audited financial reports of the asset management companies and the funds they manage, and
- Conducting periodic examinations of the asset managers to assure that they comply with best practices as determined by the regulator,
- Reviewing management company promotional material and sales practices to protect potential clients from relying on false and misleading information, and
- Establishing and overseeing a grievance and dispute resolution mechanism.

> The Association of Investment Management and Research in the United States has developed a very useful methodology for performance measurement that could be readily adopted by the Indian regulators. The methodology is designed to assure that all companies report their investment returns on a fair, transparent and consistent basis. Thus, asset management clients are enabled to compare results on a risk adjusted basis and determine which managers best meet their needs.

The pension regulator should coordinate with the Securities and Exchange Board of India (SEBI) to avoid duplication of effort and unnecessary burden on the asset management companies, the Central Bank to avoid duplication and unnecessary burdens on the banks, and with IRDA to avoid such duplication and burden on insurance companies. Such burdens would likely only be passed onto the pension plan participants, reducing their retirement income.

5.2 Civil Services Pensions

5.2.1 Indian Civil Service Pensions: A Policy and Regulatory Perspective

Though the system of civil service pension payments existed in India since the British times, the current provisions relating to payment of pensions to Central Government Employees were codified in 1972. The principal features of the Civil Servants pension program are:

- There is no regulator of civil service pension programs: the Government is the employer as well as the administrator and supervisor of these pension schemes.

- There is no specific legislation for regulating, managing, or supervising the pension program; the authority is derived.

  - The Indian Constitution (vide its Articles 309, 310, 311, 312) provides for the Indian Parliament/State Legislature to enact suitable laws and regulations for employment, tenure and termination of government employees. While a few legislative enactments such as the Indian Administrative Services Act, Indian Railways Act, etc., have been enacted, they cover only certain categories of employees in the areas of recruitment, tenure, etc., of the particular services governed by those Acts [Matters relating to pension of government employees in general, however, are not regulated by those Acts]; and by virtue of the provisions contained in Article 313 of the Constitution, most of the Rules governing the recruitment, control, tenure and termination of government employees, which were in force prior to the advent of the Constitution, have been continued and all such Rules have legislative force even now.

- ➢ The Government has codified pension rules in 1972 applicable to employees in various departments, which now govern the sanction, disbursement and other administrative matters relating to the payment of pensions to government employees and these Rules are statutory.
- ➢ Successive Pay Commissions[1] have recommended improvements to the terms as well as the quantum of pensionary benefits, which upon Cabinet approval and Gazette Notifications are implemented by various departments under central government.
- ➢ While there is no legal compulsion, State Governments have by and large adopted the Pension Rules applicable to Central Government employees.

5.2.2 Retirement Benefit Structure of Central and State Government Employees

Retirement Benefits to Government Servants is a three-tier structure:

- A lump-sum gratuity, paid upon retirement or death of the employee. The amount is based upon the length of service and is a multiple of the last pay drawn, with a ceiling of Rs. 3.50 lakhs. The program is governed by the Payment of Gratuity Act 1972. Employees do not contribute to this scheme; it is funded from Government budgets. The team was told that this scheme is gender neutral.

- A mandatory defined contribution scheme called "General Provident Fund" to which an employee subscribes with no matching contribution from government. Currently, the contribution rate is 6%. The accumulated fund, along with interest, is paid upon retirement or death of the employee. The team was told that this scheme is gender neutral.

- An unfunded defined benefit "Pension", paid to an employee on super-annuation, voluntary retirement, death, or disablement. The pension is based on the employee's last 10 months salary with a maximum replacement rate pegged at 50%. Pensions are indexed with 100% neutralization through a "dearness relief" and also to the salary changes occurring through revisions as recommended by pay commissions.

5.2.3 Coverage, Portability, Funding and Accounting – Central and State Government

Funding: The Pension Program covers all employees of the Central Government [2]. Though there is no legal compulsion on State Governments, they by and large have adopted the same rules of pension as apply to central government employees. The difference however, is that

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[1] Once in 10 years, the Government appoints a pay commission with certain specific terms of reference that includes determining retirement benefits to the employees. The pay commission recommendations are generally accepted by Central Government as well as State Government. Currently, the Fifth pay commission recommendations are in effect.

[2] There are five major sub categories of Central Government viz., (i) Civil (ii) Defence (iii) Postal (iv) Railways and (v) Telecom

Central Government pensions are funded out of the consolidated central budget, while State Government pensions are funded from their respective state budgets. Therefore, the deficits need to be funded either by grants or some other relevant tools.

Portability: The existing system does not afford portability from one system/scheme to the other/s either within the civil service sector, or between the civil service and private sector. This is a hindrance to labor market mobility.

Accounting and Record-Keeping: Since the scheme is un-funded and non-contributory, there are no collections from employees and hence, no system of contribution accounting is in place. While the sanctioning authority is the respective ministry/department to which the employee is attached, the issuance of pension payment orders takes place out of respective accounting controllers offices. For example, the central (civil) pensions are authorized and disbursed through the central pension accounting office. The actual payments are generally made through public sector banks and in a small percentage of cases, through the treasury departments attached to ministries. While there is no data to substantiate that claims processing and enforcement is tardy, we understand the process is time consuming and delayed.

Coverage: The program covers all employees in the Central Government. While there are no adequate and reliable data to estimate the number of employees and pensioners, various studies put these numbers at anywhere between 12 million to 16 million for the total employees, of which the central government employees constitute 4 to 5 million. Our own discussions with various government and private sector employees indicate the central government force at 4.5 million and state government at around 12 million.

Coverage Numbers at a Glance

- Total Labor Force -400 mn
- Total Salaried Force – 44.5 mn
- Total Government force – 16.5 mn

Liabilities: The pension bill for the central government for the aforesaid estimated number was Rs. 3272 crores, which increased to about 20500 crores by 2001, and further estimated to increase to between 30000 - 34000 crores by 2010. (*A crore is Rs. 10,000,000; a lakh is Rs. 100,000)

Estimation of Pension Liabilities – A Working Group Report findings

In 1999, a working group convened to estimate the central government's pension liability towards existing and future retirees. Among the principal findings were:

- available data on employees and pensioners was inadequate and unreliable to use modern methods based upon actuarial analysis to estimate the pension liability;
- the impact of future pay commission/s recommendations with respect to wage and pension revisions can distort the current estimates

Given the inadequacies of existing data, the committee used a simple extrapolation to arrive at best estimates of the future pension liability. These estimates indicate that outlays for pension payments will be about Rs. 20500 crores (2001) increasing to 29890 crores (2010), at 6% inflation, Rs. 20,700 crores (2001) to 31,710 crores (2010) at 8% inflation, Rs. 20975 crores (2001) to Rs. 33,550 crores (2010) at 10% inflation.

5.2.4 Civil Service Pensions - Gap Analysis

S No.	Issue	Gaps
1	MIS/IT	• Because the current system does not require historical data, an entirely new system must be designed.
2	Accounting and record keeping	• The government bodies have no records on key employment data needed to analyze and manage a modern pension system.
3	Claims process – timeliness of paying claims	• The claims process is time consuming, delaying prompt payment of pensions.
4	Collections process	• Since this is a non-contributory, defined benefit program, there are no collections.
5	Compliance and audit function	• The only compliance is pensioner driven when pensions are less than mandated. • There is no control to assure pensions are neither too high nor too low. • Independent audits are not conducted.
6	Information dissemination programs and customer satisfaction	• The pension formula is very simple and, we believe, well understood by the employees. In general though, there is very little information available about this program. • Since the civil service unions have been actively involved in system design, customer satisfaction is positive.
7	Skill level of staff, resource requirements, training needs	• Current system only computes based on last 10 months salary. Staff will have to be trained in the new system and qualified to perform new duties.
8	Appeals process and timeliness and efficiency	• Accuracy and timeliness should be goals of the new process. • The existing appeals process is cumbersome and time consuming. • The new system will be more complex and should include a new streamlined appeals process.
9	Legal and regulatory environments	• Existing legislation is adequate for supporting the current system. This system, however, is not sustainable.
10	Supervision and oversight	• No oversight.
11	Actuarial and other financial systems	• There is no actuarial analysis of the civil service pension program. It is simply pay as necessary.

5.2.5 Reform Initiatives underway

The impetus for pension reforms in Central and State Government sectors is the growing incidence of pension payments and the financial stress that it has been causing to the central and state budgets and policy makers, particularly in the last decade. The current dependency ratio is very high (3 workers for 2 retirees) and is expected to worsen on account of the high rate of retirement in the next 10 years, and decreases in new employment. A voluntary retirement scheme under consideration to reduce payroll costs could further upset all estimates. All these have led to the ***Finance Minister announcing in his budget speech (annual budget 2001-2002) that beginning October 1, 2001, all new recruits in civil service will not be eligible for pensions under the current system and they will be covered under a new funded pension program to be designed and implemented by the Government. However, the Government has not yet designed a new program.***

Given the fiscal stress on the country's financial system, the Government has constituted a committee under the Chairmanship of Mr. K. Bhattacharya (retired chief secretary, Karnataka State Government) to recommend a road map for changeover to a new fully funded pension system for all new employees of the Central Government. The Committee is expected to submit its report by end December 2001.

5.2.6 Technical and Capacity Building Issues in Reform

Though a "Champion" has not been identified as yet, key figures at the highest levels of government (with required political clout) recognize that targeted reforms in the civil service pension sector is a must if the Government is to reduce the enormous existing financial burden. Our discussions with various ministry staff and private sector reform advocates suggest the following issues as of paramount importance for the reform. Appendix 2 provides a synopsis of international experiences and lessons learned in national and civil service pension reform.

- *Identify a "Champion"* to spearhead the reforms not only in civil sector, but to integrate civil pension system into a national pension system for the organized sector as a whole.

- *Use modern methods to estimate pension liabilities, based upon actuarial analysis*. At present, the lack of data and unreliability of existing data precludes the ability to assess the Government's pension liability with any degree of confidence.

- *Design a new funded system based upon international best practices and ability to invest on risk return curves with use of modern invest management techniques*.

> ***Information Requirements for Pension Determination and Assessment of Liabilities***
>
> - *Data relating to number, age profile, gender profile, length of service and pay characteristics of employees in service and those of pensioners;*
> - *Distribution of Pensioners over different categories of service and pay drawn.*
> - *Target replacement rates and inflation statistics*

- *Designate a suitable regulatory and administrative authority even for government pensions*. While there is still ongoing debate about who should have authority over civil service pensions, the need for such authority is felt across the cross section of people interviewed by the team.

- *Draft suitable legislation and set up effective compliance and administrative oversight function*. As previously stated, no single, comprehensive legislation for pensions exists. Additionally, the areas of supervision, compliance and enforcement need to be strengthened.

- *Computerize and use modern information technology tools in administration of pension systems*. Several departments, including the Central Pension Accounting Office responsible for payment of pensions, are not fully computerized. This precludes effective oversight and compliance.

5.2.7 Possible Areas of Technical Assistance for Civil Service Pension Reform

S No	Recommendation	TA	Training	Comments
1	Computerization of pension payment system, data capture, retrieval, management and MIS	X	X	• Recipients will be respective departments and accounting offices
2	Analysis of current civil pension liabilities at central and state levels including data collection based on sampling techniques and actuarial projections.	X		• The Government of India needs to estimate its current liabilities and have a means for estimating the liabilities associated with other changes in its pension program. Since the basic data needed for such estimates does not exist, a project to accumulate the data on a sampling basis and create a modelling tool would provide an important support for civil service pension reform.
3	Design of a new fully funded pension system with recommendations on appropriate legislative framework, investment management rules, Generally Accepted accounting practices, etc	X		• A Long Term Technical Advisor can provide major assistance to the GOI ministries in creation of a new pension system. The work of this advisor will be leveraged if the design process encompasses reform of pension in the public sector, organized and unorganised segments of the private sector. The advisor may be posted on a full time or intermittent schedule and should work closely with the "Champion" identified by the relevant ministry.
4	Training of Board of Trustees, Pension Fund Managers, Administrators,		X	• The Long Term Technical Advisor should also design and implement training programs for key managers and administrators of the civil service pension program covering the new pension program.
5	Writing a suitable legislation for a new fully funded system including investment management rules,	X		• After the design phase, it will be very important for the implementing legislation to reflect the desired new pension system faithfully. The legislative process can include unintended impacts if not reviewed carefully by those who created the pension system.
6	A pilot project in a selected state – inception to completion	X	X	• Most states will follow the lead of the central government pension reform. A pilot program in one of the progressive states will be helpful to all the states as they apply the tenets of the central program to the needs at the state level. Long-term technical assistance will be very useful in this regard.

5.3 Advocacy, Education, and Consumer Protection

As indicated in the Terms of Reference, one of the criteria for successful pension reform in other countries has been the transparency of the pension system as well as the understanding of the scheme by the participants and their trust and confidence in those administering the system. All of these areas pose challenges to successful reform in India at the present time. The current pension schemes in the private sector are poorly understood and confidence in the schemes and the institutions administering them is also poor. This has resulted from a lack of public education and understanding as well as prior poor performance and customer relations by those administering the programs. The Employee Provident Fund Organization (EPFO) has recognized these problems and has embarked on an ambitious program to redesign its processes with a customer focus and to develop a better public understanding of its programs.

On the other hand, the civil service pension schemes have existed for years with great confidence by members that they will be paid promised pensions. Since these are basically unfunded, defined benefit schemes depending on current government revenues for funding, there has been little need for members to become familiar with the workings of the system except for understanding the potential value of their retirement pensions. Both the employer and the employee have come to view these benefits as deferred compensation. Additionally, since benefit amounts under these schemes have been generally determined based on calculations using salaries during only the final year of work, there has not been any accumulation of information on the make-up of the covered workforce. Therefore, little understanding or statistics regarding this population exist.

For the vast majority of workers (the 90% of workers in the informal sector) there is no existing pension scheme. Understanding of, and trust in, existing savings schemes and provident funds for this sector appears to be very limited as is the take-up rate for these programs.

In summary, knowledge about pension and related savings schemes is limited as is the general knowledge of the working of the financial markets. Some education has begun in the area of products available in the insurance market, but this has been generally limited to materials relating to insurance products offered by a particular company. There is a wide scope for education of the public in this area. Because of the lack of awareness of the importance of this public information, there is even a greater a need to educate those involved in creating or reforming programs. This education would explain the rationale for the desirability of informing the public about program design and disseminating relevant information. There should be an effort to explain the methods useful for achieving these ends in the design process as well as the ongoing operation of these programs. Regulators will need to be trained in methods for recognizing how to include effective provisions for education in the program guidelines. At the same time, education about the value of and need for confidentiality of data regarding an individual's earnings should be included with the basic education regarding pension design.

5.3.1 Reform Initiatives Underway

Currently, some very positive efforts have been initiated. The Federation of Indian Chambers of Commerce (FICCI) has established a pension reform task force that has begun to spell out needs in this area for employer education. Also, a non-profit organization, the OASIS Foundation has recently been created with the goal of providing consumer education in the financial area.

5.3.2 Technical and Capacity Building Issues in Reform

We see the desirability of holding a series of seminars for policy makers and administrators very early in the design or reform phase. Both the World Bank and the Asian Development Bank have held or scheduled pension reform conferences for the region and various donors (including USAID) have sponsored study tours for particular persons or staffs to gain information about basic reform principles and/or particular country experiences. It would be effective now to develop and deliver several publications and seminars specific to consumer protection, education, and advocacy in the pension and savings sector for a broader group of potential administrators for these programs before final design and implementation occur. These efforts would take several different forms and cover various topics. One of the first efforts that should be undertaken is the development of a basic introduction to pension reform in the Indian context. This document and related seminars would define the basic terminology being used and provide an understanding of the interrelationship between related programs and the need for data exchange between the various related programs. The document should be cleared by the various major players to ensure objectivity and credibility.

There is also the need to deepen the understanding of these concepts within the central and state government senior staff. The private sector staffs in the financial arena and related NGOs would also benefit from this kind of training.

5.4 Training and Research

The attention directed toward issues of the aging of the population and discussions about the alleged breakdown of the extended family support structure in India have increased the interest in research projects related to the pension area. Currently, the FICCI has created a research arm directed toward the insurance sector and has indicated an interest to take similar action in the pension area. They have an existing work group on pensions. This type of effort could address issues of particular interest to the employer community. Many employers in our discussions indicated an interest in developing pension plans if and when the regulatory climate is modified.

In the United States, the Employee Benefit Research Institute (EBRI) has been a very effective research, training, and advocacy body for the needs of employers in all employee benefit related areas. Development of some kind of "twinning" arrangement between FICCI (or a similar body) and EBRI would appear to offer great potential for offering a voice for employers in the development of the pension and related areas.

5.4.1 Reform Initiatives Underway

In the area of more general research, several organizations and individuals have shown interest. The recently formed OASIS Foundation has included research in the pension area among its primary goals. The ILO has provided training to unions in the overall social security arena and has included India in its scope of research. The Social Security Association of India has also written some background on pensions as part of their overall compendium of social security programs in India and may be doing some further work in conjunction with the International Social Security Association. Several universities and Institutes have also indicated a willingness to do more research in the field of pensions. The Association of Mutual Funds of India has also indicated an interest to work in the pension field.

5.4.2 Technical and Capacity Building Issues in Reform

It would be helpful to have an oversight body to stimulate research in needed areas and to try and ensure some objectivity. The ADB has indicated an interest in possibly funding the start up of a pensions research institute for India and the World Bank has indicated that it will establish a fund for this purpose. Our view is that such an oversight or guiding force should be under the guidance of a body including a broad representation of interests and having some recognized authority. We believe that an institute or oversight body should be created under the direction of the person or group that is given general responsibility for oversight of pension reform activities. This group could include such functions as:

1. Oversight of research papers and studies.
2. Serving as intermediary for developing research proposals and soliciting offers.
3. Serve as clearinghouse and facilitator for work in the field
4. Linking with international and regional bodies in the field of pension research.
5. Serving as a reference point for questions in the pension field.
6. Serving as a repository for information about current pension programs and reform efforts.

Start-up funding for this effort from a variety of sources could be utilized for hiring of a permanent director and two or three research assistants. These funds might also be used for furnishing the office with some equipment and a library of initial materials. After the first two or three years the Institute should become self-sustaining.

5.5 Other Potential Areas of Assistance: Operations

While assistance in the area of operation of pension programs was not specifically included in the terms of reference for this review, there are a few needs that emerge as excellent opportunities for assistance to be provided by USAID. We believe that the two potential assistance projects described below offer potentially high payoff for the pension sector and beyond.

The first and most overriding opportunity exists in the area of developing a unique identifier for workers participating in pension programs. Currently, there is no unique ID for Indian citizens. There is no internal passport or other generally accepted means of establishing identity. Combined with problems of literacy, the lack of birth certificates for many people, and various name duplications, this creates a real challenge for differentiating between individuals and tracking of pension accounts or even basic information for research purposes in the financial and social areas. The ultimate goal of the pension reforms would be to have some sort of portability between pension schemes to promote (or at least not restrict) portability of labor between employers and sectors. For any defined contribution pension scheme some basis for establishing and tracking individual accounts is essential. A basic ID system serves as the backbone for almost every large pension scheme in the world.

Currently, the Employee Provident Fund Organization (EPFO) manages the largest single set of pension and provident fund schemes in the country. Their programs include about 28 million workers from various industries and localities. Without a national unique ID, workers change account numbers each time they change employers. This creates significant problems in record keeping and accounting during the accumulation phase and problems of potential fraud in the payout phase. The EPFO has recognized this problem and is currently in the process of having a contractor design the facility to assign and issue unique identification numbers to all of its current and future members and their families. All of the persons interviewed in this project acknowledged the need for such an ID system for India not only for the pension administration but also for being able to accumulate data for research and planning purposes. The EPFO is attempting to design a system that could be expanded to accommodate the identification of all workers and perhaps even all citizens at some point in time. The problem or opportunity that exists is the lack of the funds for the design of a system of such scope and a plan for further implementation beyond the EPFO covered population. Without such a plan it appears that other interested parties will go on developing their own means of differentiating between individuals for account keeping or other financial transactions.

Based on experience with the use of the social security card system in the US and new emerging technologies used in such areas as the INS green card, it would appear that expertise available from the US public and private sectors could be invaluable to GOI in developing this opportunity. In addition to fingerprint and biometric technology, the assistance could include the experience of the US social programs in designing matching programs and research efforts using the identifier established. Likewise, there would be an opportunity to build in necessary and desirable protections of privacy and freedom of information for citizens to access information about themselves. If India properly develops and implements an effective individual ID system it would not only help the pension sector and the broader financial community but could prove very helpful in administering various social programs, voting cards, and many other purposes including research.

What is needed now is the designation of a lead within the GOI to take the effort forward and an agreement about the scope of assistance USAID may be willing to offer.

In a related area, the EPFO has recognized their need to develop a records management and retention system. Decades of paper files have been accumulated and a high volume of information is added almost daily. With the implementation of their future automated system, most of these records will be in electronic form. The electronic records will create management and efficiency challenges and there is the whole issue of transition from paper to electronic storage. Those responsible for planning the new defined contribution pension scheme will face the same issues. Both of these organizations have asked for help in this area. Here again, U.S. experience in the public and private sector could offer significant advantages to the organizations as they move ahead in these areas

6 RECOMMENDATIONS

6.1 Overview of Intervention Options

Based on the needs assessment and gap analyses, the Team identified a wide array of short and long-term options for USAID intervention, as described in Section 5. These options address a variety of distinct and important needs. Many of the options for assistance address common issues, and should be tackled together in order to obtain synergies. Therefore, where appropriate, we have combined some of the potential areas of assistance detailed in Section 5 into a more focused set of intervention options. These include:

1. Design and implement national data collection system
2. Create Indian EBRI-type Institute
3. Create Pension Research Institute (to be housed within Government)
4. Provide ongoing long-term technical assistance to Pension Reform Task Force (PRTF) and pension regulator
5. Design and implement universal ID system
   - Phase 1: Design system
   - Optional Phase 2: Implement system
6. Conduct public education programs
7. Upgrade EPFO records management systems (accounting, financial, etc.)
8. Design and implement civil service pension reform program
9. Develop and implement pension program for informal sector and uncovered formal sector workers

The table below provides details on the various intervention options including a brief description of each option, presence or lack of Indian sponsor, key drivers involved in intervention, general cost and time estimates, and expected results.

Description	Sponsor	Key Drivers	Cost and Timeframe Estimates	Expected Results
1. Design and Implement National Data Collection System	MOF, Min. Personnel, Min of Soc Justice, Revenue Department, etc.	• Existing databases are insufficient, therefore cannot assess or track key demographic and economic trends needed to make considered policy decisions. • Will yield important and long-lasting impact. Requires consensus and coordination b/t ministries, significant investment of time, high cost.	• 1 LT Team leader to assist in identifying data requirements, design survey and forms • Local nationals to collect and analyze data • IT/MIS and operations experts to design system • Estimate: $3-5 million over 3 years	• An accurate data collection system that can be used by numerous ministries to track trends in order to make informed policy decisions and interventions.
2. Create Indian EBRI-type Institute	FICCI (Note: Government sponsor not needed, is employer sponsored)	• No similar employer – focused institute exists in India. • Can be implemented easily and quickly at low cost, fits w/USAID comparative advantage; fits w/other USAID programs (FIRE).	• 1 senior pension policy expert intermittently over 1 year to advise on establishment, make up, functions of Institute • Exchange program for FICCI staff • Estimate: $500,000 – 1 million, over 1 year	• Well respected Institute that undertakes research, disseminates information, and educates public and policymakers about pension reform • Relationship building and outreach with Indian business community • Informed and responsive employer community

Description	Sponsor	Key Drivers	Cost and Timeframe Estimates	Expected Results
3. Create Pension Research Institute (to be housed within Government)	Undetermined	• The World Bank & ADB are considering providing assistance to establish this Institute, so does not fit w/USAID comparative advantage. • Requires wide consensus on where it will be housed, who will manage, mission, etc. Once consensus on these issues is agreed to, can be implemented quickly and at low cost.	• 1 senior policy expert to advise on establishment, make up, functioning of Institute • Conduct studies, briefing papers, seminars • Estimate: $1 –2 million, over 1-2 years	• Facilitation of common approaches to pension reform.
4. Provide ongoing LT Technical Assistance to PRTF and Pension Regulator	MOF	• Sustained program of assistance over the LT is needed in order to respond to policy, regulatory, supervision and enforcement issues as they arise. • Moderate cost, fits w/USAID comparative advantage and objectives, presence of sponsor.	• 1 LT pension and regulatory policy Team Leader to provide advice to PRTF and pension regulator over 2-3 years • Approx. 18 months of ST LOE to be provided by resource pool of ST experts in: actuarial analysis, data gathering/analysis, regulation of pensions, insurance/capital markets regulation. • Estimate: $2.5 - 3 million over 2-3 years	• Sustainable and India-appropriate regulatory structure with competent, well-trained staff. • Ability to work side-by-side w/GOI to directly shape policy reform initiatives • Provision of best practices and lessons learned from international experiences

Description	Sponsor	Key Drivers	Cost and Timeframe Estimates	Expected Results
5. Design and Implement Universal ID system	Undetermined	• No such system exists. Without it, cannot track individual accounts or trends, ensure compliance, or respond effectively to inquiries. • Requires significant investment of time, effort and cost, participation and coordination across ministries.	• *Phase 1 – Concept, Planning, and Design*: 1 LT Administration/Policy expert to advise on design and set-up • Estimate: $500,000 - million over 1 year • *Optional Phase 2-Implementation:* 1 LT Operations/MIS expert; Mid-level operations/MIS expert; Indian systems expert, other short-term experts as needed; local nationals as needed. • Estimate: $5-10 million over 3 years	• In Concept/Design phase, could tie into other government needs-based programs (old age social assistance plan), voter registration, passport, etc. • Ability to track individual accounts, improve customer service, ensure responsible monitoring, supervision and corporate governance, track financial performance.
6. Conduct Public Education Programs	Undetermined	• Should be implemented only after program design has been agreed upon, and accompanying legislation passed. • Relatively easy to implement, cost is variable depending on level of activity, impact difficult to measure.	• 2-3 ST experts to design programs • Roll out of Train-the-Trainer programs • Estimate: $2-3 million over 2-3 years	• Dissemination of information, consumer protection and advocacy, thereby increasing interest and participation in programs.

Description	Sponsor	Key Drivers	Cost and Timeframe Estimates	Expected Results
7. Upgrade EPFO Records Management System	EPFO	• Existing systems are inaccurate, slow, and inefficient. EPFO has poor record of customer service due to lengthy delays in processing claims, lack of confidence in ability to collect contributions, loss of account information, perceived low compliance. • Lack of faith in EPFO contributes to low actual coverage vs. target coverage. In addition, some programs are unsustainable (implicit government liability), and do not contribute to capital market development.	• 1 LT IT/MIS/Operations Team Leader • 1 LT international accounting and audit standards expert • Short-term resource pool of experts as needed in: accounting reform, audit and compliance, corporate governance, financial analysis, etc. • Training in new system, accounting, audit, etc. as needed • Estimate: $1 million, over 1 year	• Reduced turnaround time on claims processing, increased compliance, and overall better customer service, thereby generating interest and participation in program. In turn, increased participation in programs will facilitate build-up of funds and will contribute to long-term sustainability of programs. • *Could be linked with Civil Service records management efforts.

Description	Sponsor	Key Drivers	Cost and Timeframe Estimates	Expected Results
8. Design and Implement Civil Service Pension Reform Program	Ministry of Personnel, DPP, MOF	• Un-funded liabilities are large and are projected to increase rapidly in the future, representing huge financial burden on central government budget. • Sponsors exist, priority is high, fits w/USAID comparative advantage, no other donors active, fits w/ USAID objectives, will have enormous impact.	• *Phase 1 – Design*: 1 LT policy& regulatory Team Leader (full-time for year 1, intermittent or full-time as needed for years 2-3); ST experts as needed in: regulation and supervision, actuarial analysis, asset management, etc; 1 year I duration. • *Phase 2 – Implementation*: 1 LT operations/MIS Team Leader; policy/regulatory expert in Phase 1 to provide intermittent assistance as needed; Variety of ST experts to provide assistance and training as needed in: (1) regulation and oversight; (2) finance, accounting, auditing systems for pension programs; (3) asset management; (4) IT; and (5) public education programs. 2 years in duration. • Estimate for Phase 1 and 2: $2-4 million over 3 years	• Funded, sustainable old age pension program for civil service workers, decrease in central government liabilities. • Achievement of 4 objectives of any pension program: provide adequate income for retired workers, cover targeted workers, financially sustainable over LT, facilitate or at least not hinder capital market development. • Potential model for adoption by state-level civil service programs

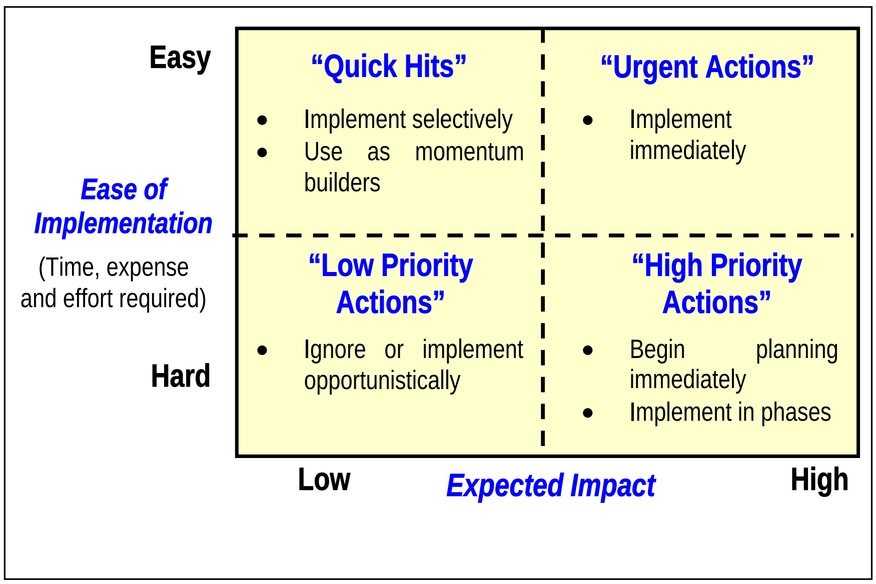
Description	Sponsor	Key Drivers	Cost and Timeframe Estimates	Expected Results
9. Develop and Implement Pension Program for Informal Sector and Uncovered Formal Sector Workers	Undetermined	• Although there are few options for informal sector workers or uncovered formal sector workers and it would be desirable to have programs for them, reform of existing private sector and civil service pension programs must first be conducted before embarking on developing and implementing new plans. • Time, effort, and expense of setting up plans is high, implementation will be difficult if undertaken now. Ministerial authority for program has not yet been determined, priority is not high as compared to other possible interventions	• *Phase 1 – Design*: 1 LT pension and regulatory policy Team Leader; variety of ST experts to provide assistance in as needed in: asset management, IT, etc. • *Phase 2 – Implementation:* 1 LT Operations/MIS Team Leader; policy/regulatory expert in Phase 1 to provide intermittent assistance as needed; ST expert in developing public education programs. • *This scenario assumes that regulatory body has already been established • Total cost estimated at $500,000 over one year • *Estimated cost depends on whether the system is integrated with existing systems and regulatory structures.	• Achievement of 4 objectives of any pension program: provide adequate income for retired workers, cover targeted workers, financially sustainable over LT, facilitate or at least not hinder capital market development. • Dramatic increase in covered workers, providing them with means to plan for retirement.

6.2 Assessment of Intervention Options

Although the Team identified numerous potential areas for intervention as outlined above, USAID must direct its limited resources at specific areas of need. In order to determine which areas provide the best opportunity for intervention, the Team generated a set of common screening criteria against which each option was assessed. These criteria include:

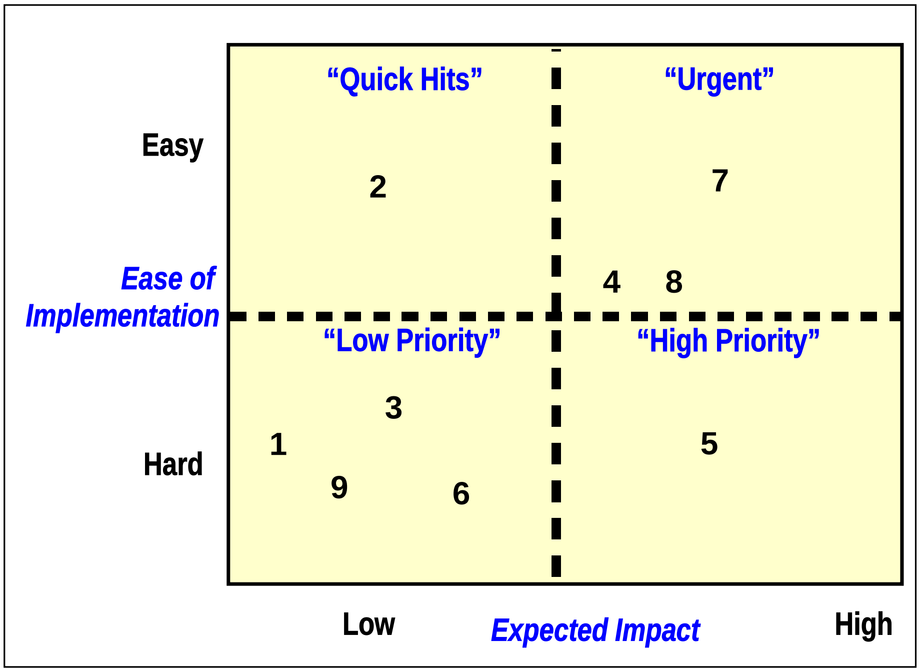
- Comparative advantage of USAID vis-à-vis other donors and providers of assistance
- Fit with USAID overall country objectives
- Likelihood of achieving sustainable, impact-level results
- Cost of proposed intervention vs. expected results
- Priority of intervention vis-à-vis other possible interventions
- Ease-difficulty of implementation: level of interest and presence of sponsor or 'champion' within Indian government, timescale for implementation, need for legislative changes, need for consensus or coordination with other government agencies, etc.

The graphic below depicts our framework for prioritizing intervention options.



1. *Quick hits* include interventions that can be implemented quickly, easily, and at a low cost. While often not high priorities, these interventions do yield important benefits and are good momentum builders.
2. *Urgent actions* are interventions that can begin quickly, are moderately difficult to implement, and yield a high degree of impact.
3. *High priority actions* are interventions that will have major impacts, but that are difficult to implement and require significant planning and investment of time.
4. *Low priority actions* include interventions that yield low impact and/or are difficult to implement. These are recommended only opportunistically, as the opportunity cost of ignoring an urgent or high priority intervention is prohibitive.

Using this framework, and based upon the criteria noted above, the Team assessed each intervention option. The graphic below depicts the results of the Team's assessment.



The table below provides details on which intervention options were eliminated and rationale why.

Intervention Option # and Description	Rationale
1. Design and implement national data collection system	• *Pros:* Will yield broad impact • *Cons:* Is difficult to implement b/c requires consensus and coordination of several sponsors w/in Gov't. is time consuming and costly is not as high a priority for intervention as other options. Does not necessarily fit with USAID objectives or comparative advantage.
3. Create Pension Research Institute	• *Pros:* Yields moderate impact • *Cons:* World Bank and ADB are already considering providing assistance to establish the Institute so does not fit w/USAID comparative advantage. Requires wide consensus regarding which ministry will preside over it, which will likely be result in lengthy debate.
6. Conduct public education programs	• *Pros:* Relatively easy to implement, fits w/USAID comparative advantage and overall objectives, can be done at low cost. • *Cons:* Moderate impact, cannot be implemented until program design is set.
9. Develop and implement pension program for informal sector and uncovered formal sector workers	• *Pros:* Will lead to large increase in covered workers providing them with retirement income, fits w/USAID objectives.

Intervention Option # and Description	Rationale
	• *Cons:* Reform of existing civil service and EPFO programs are more urgent, lack of sponsor, will be time consuming and costly to implement. • ***Note: Once EPFO and civil service programs are set up and operating efficiently, this program could be designed and implemented quickly. Therefore, it is a possible long-term option.***

6.3 Recommended Interventions

This section includes a detailed description of each proposed recommendation, rationale for intervention and expected results, and general cost estimates.

Intervention #2: Create Indian EBRI-type Institute

Description:

The purpose of this intervention would be to establish an EBRI-type institute within India. The FICCI has formed a pension committee and a research group in the area of insurance. The FICCI has indicated its interest in sponsoring or hosting an Indian EBRI. This would involve intermittent assistance over the course of nine to twelve months from a senior, well-respected pension policy expert who would oversee the initiative. This person would spend some initial time in India to develop the concept with appropriate counterparts and design the structure of the Institute. Design activities would include outlining the overall mission and objectives of the Institute, undertaking a brief needs assessment to determine target areas for research and analysis, and developing an employer and public education campaign and other information dissemination and outreach activities. The expert would also assess existing skill capabilities and then arrange for 2-3 selected Institute staff to work side-by-side with counterparts in the Washington offices of EBRI. He/she would also assist in identifying and procuring necessary equipment and materials for the use of the Institute.

EBRI At-a-Glance

- EBRI is a non-profit, non-partisan organization committed to data dissemination, policy research, and education on economic security and employee benefit issues.
- It's mission is to advance employers', the public's, media's, and policymakers' knowledge and understanding of employee benefits and their importance to the national economy.
- Its members include private corporations, mutual funds, pension funds, insurance companies, banks, trade associations, labor unions, and many others. It receives its funding through member dues, grants, and contributions. It does not advocate or oppose specific positions – its aim is to educate people.
- EBRI's activities include sponsoring of research, lectures and roundtables, disseminating information, and educating the public.

Rationale:

This proposed intervention is a "quick hit" for several reasons. First, it can be implemented quickly. Second, it does not require a formal Government sponsor, as it is an employer-based organization, and the FICCI has already indicated its interest in sponsoring such an Institute. Third, USAID can facilitate links with the U.S. EBRI and other organizations, something that other donors cannot do, and therefore, USAID possesses a distinct comparative advantage to undertake this activity. Fourth, start-up costs to establish the Institute are quite low and once established, it is self-financed through member dues. Finally, and most importantly, *while it can be implemented at a low cost, it will have an important impact over the long-term, so the up-front costs will be recouped and will pay off in positive results many times over.* In the U.S., EBRI's ability to undertake research on important topics and gather critical data, all in a non-partisan manner, has resulted in it being a highly regarded Institute by the business community, general public, policymakers, and the media. It has successfully leveraged its reputation to reach out to a wide and diverse audience of these stakeholders to educate them about the importance of pension issues and its impact not only on old age income but on the overall economy as well. This intervention would enable USAID to bring the experience of the U.S. employer community to India. An Indian Institute would potentially yield similar positive results of consumer advocacy and public outreach and would be a high-profile success that USAID could leverage to continue to build strategic alliances and productive relations with the Indian business community.

Cost:
Costs would include intermittent technical assistance to be provided by a senior pension expert over a period of 9- 12 months. Additional variable costs would cover study tours for Institute staff, exchange programs, other training and capacity building initiatives etc. Other costs could include expenses for the acquisition of basic documents and software programs such as library research, LEXIS-NEXIS type services, etc.

Total costs are estimated at $500,000 to $1 million, depending on the extent of training and capacity building initiatives.

Intervention #4: Provide Ongoing Long-term Technical Assistance to PRTF and Pension Regulator

Description:
The overall purpose of this intervention would be to provide support both to the Pension Reform Task Force (PRTF) as well as to the eventual pension regulator, be it IRDA or some other regulator. The three main objectives would be to: (1) set the direction and ensure understanding of key issues among relevant policymakers and stakeholders, (2) establish a regulator appropriate to the unique Indian environment, and (3) implement programs and build capacity among key players. A senior pension specialist/Team Leader would assist the PRTF to set the direction and priorities for pension reform activities, help stakeholders to understand the key opportunities and constraints, develop reform options, and agree upon final reform plans. He/she would be available on a daily basis to provide advice within the MOF on these issues and to assist in coordinating the agenda and activities of the PRTF and the pension regulator, and in coordinating relevant activities with other ministries as needed. For example, activities could include redesign of EPFO plans to better achieve four objectives (provision of old age income, coverage of large portion of population, long-term financial sustainability, contribution to economic growth and development of capital markets), create an appropriate regulatory framework for private pensions, and possible eventual creation of a voluntary scheme for informal workers, or merge of civil service scheme into national scheme. The Team Leader would also be responsible for several other activities. For example, he/she would research the experiences of other countries and assisting the PRTF in assigning research activities. He/she

would identify and coordinate the work of a resource pool of short-term experts who would provide assistance in specialized issue areas such as actuarial analysis, data gathering and analysis, pension regulation, capital markets, and insurance regulation. He/she would assist the PRTF to conduct seminars, workshops, etc. in particular areas of interest, and in organizing study tours for groups or individuals as needed. Finally, the Team Leader could help to establish the Pensions Research Institute (depending on World Bank and ADB involvement).

Rationale:
This intervention is a mix of high priority and urgent priority. The importance of pension reform is evident; undertaking pension reforms will yield long-lasting and significant results, while the adverse impact of doing nothing is high. Achieving consensus on the way forward will require significant investment of time and effort on the part of key stakeholders, and will not be easy. However, this intervention fits with USAID's comparative advantage and overall country objectives. *It will also enable USAID to have a permanent 'seat at the table' with the Indian Government and other donors, and play a major role in shaping critical pension policies, which will have long-term economic impacts.* In turn, this will help USAID build its stature and relations within the Indian business community and the public. *Moreover, since developments in the pension sector impact capital markets, USAID can leverage its pension sector activities with its ongoing capital markets development initiatives under FIRE.*

Cost:
Costs would include one LT Team Leader/pension policy expert for 2-3 years. In addition, costs would include about 18 months of short-term technical assistance to be provided by the resource pool on an as-needed basis. This resource pool could include an actuary, an investment/capital markets expert, a pension regulatory expert, financial analysts, trainer, and possibly a lawyer. Other direct costs (per diem, travel, other ODCs, etc.) would need to be included as well.

Total costs are estimated at between $2.5 – 3 million over 2-3 years.

Intervention #5: Design and Implement Universal ID System

Description:
There are actually two phases of potential intervention, the second of which would be optional, or conditional upon performance in the first phase. The overall purpose of this intervention would be to design and implement a universal ID system for Indian citizens and residents. The *first* phase would focus on the project concept, planning and design and would require a long-term Administrative/Policy Design Team Leader, familiar with the integration of multiple information systems and benefits to be derived from the development and use of an unique ID system. He/she would need to be a senior-level person able to deal with the highest level of managers in various government agencies, and may be called upon to help build consensus in Parliamentary committees about the value and benefit of such a system. The Team Leader would assist the GOI in identifying the potential government users of the ID system and also assist in bringing together relevant ministries and stakeholders to agree on the type of data needed, how it would be collected, and how it would be shared. He/she should assist the GOI representative in identifying cost savings and other benefits to be derived from the system, and identify specialists to assist in ensuring the privacy and security of information.

Depending on progress achieved in the concept and design stage, USAID could opt to undertake a *second* phase of intervention, which would focus on implementation. The Team Leader would oversee a team to assist the GOI to implement the plan for actually assigning ID numbers to the designated population. Other members of the team would include a long-term Lead Analyst who would develop the work plans through various impediments through implementation, and an Operational Director responsible for assisting the GOI in assuring the assignment of numbers and gathering of information. He/she would also be responsible for establishing a quality assurance and monitoring process. The team would operate for approximately 3 years and would require some short-term technical assistance from specialists to address specific problems as they arise.

Other activities that could be undertaken once the system is operational would include analyzing incoming data to identify trends and patterns that could help in making informed decisions to refine existing pension programs, or to create a new voluntary pension program, and conducting a needs assessment to link with other initiatives such as passports, voter registration, other research, birth control, etc. New data would need to be reconciled with existing EPFO data.

Rationale:
This intervention is a high priority; it will yield large and important impacts, but requires significant investment of time, effort, and resources. As noted in the Draft Assessment, India does not have a system for assigning unique identification numbers to its citizens/residents. Currently, workers' numbers are assigned based on their employer and the employer's location. When an employee changes jobs or even job location, he/she is issued a new number and must begin accumulating income from square one. Over the course of employment, an employee may have many numbers, which clearly hampers the administration of current and proposed benefit and welfare programs. Implementing a system to issue unique identifiers will have a broad and significant impact over the long-term. It has many potential uses including: issuing voting cards, recording transactions by financial institutions, and tracking social and economic programs, etc.

It should be noted though, that undertaking this initiative would not be easy. It will require consensus and coordination between numerous ministries, and a significant investment of time, effort, and resources. However, positive impacts will be enormous and long lasting. USAID could provide assistance in the concept/design phase as well as the implementation phase, or simply the concept/design phase.

Cost:
Concept, Planning and Design: Costs would include technical assistance to be provided by a Team Leader, a mid-level operations specialist, and a local Indian national systems specialist. Other costs could include short-term technical assistance by specialists. Total costs are estimated at about $500,000 1 million for one year.

Implementation: Costs would include technical assistance to be provided by a Team Leader and two other long-term experts. Short-term technical assistance to be provided by specialists on an as needed basis would also be required. Other costs are variable, depending on the level of involvement. If the contractor assumes responsibility for establishing a distribution network to collect data, hiring individuals to collect data, and marketing the program, procuring equipment, and training staff, the project would be substantial, and would have important, broad, and long-lasting impacts. Total costs are estimated at between $5 – 10 million, over 3 years, depending on level of involvement.

Intervention #7: Upgrade EPFO Records Management System

Description:
The purpose of this intervention would be to design an appropriate records management system for EPFO that can accurately track collections contributions and benefit payments, monitor compliance, store records, and streamline responsiveness. A long-term operations/MIS/IT Team Leader and a long-term records management specialist would work with EPFO first to determine system requirements. This includes determining what records and information need to be captured, how and where the data will be maintained, guidelines on how information will be monitored, etc. They would then design an appropriate system capable of undertaking these tasks, and that can handle increased workloads as EPFO membership grows. They would be supported by a short-term resource pool of experts, as needed, in accounting, compliance, audit, financial and data analysis. After an appropriate design has been developed, the Team would help EPFO evaluate various vendor proposals and help EPFO to ensure successful implementation of the selected system, and to put in place safeguards to ensure privacy and confidentiality of data. This initiative could be extended to build a civil service records management system.

It should be noted that the actual scope of work and activities would need to be refined to dovetail with the work that Siemens Co. in currently undertaking with EPFO, and EPFO's ongoing internal efforts.

Rationale:
This intervention is an urgent priority. The four largest workloads within EPFO – coverage, contributions, accounts maintenance, and claims settlement are all plagued by the same problems. These include inefficient manual processes, unreliable record-keeping, large and increasing backlogs, and inadequate mechanisms for tracking employers and employees. As a result, compliance functions are not up to par, and perceptions of poor customer service decrease the level of participation in EPFO programs. *An efficient and accurate records management system is imperative to properly manage individual records, particularly in a defined contribution, individual accounts system of pensions*. However, the advent of automated records will speed processes, but without proper management, will simply transform existing manual problems into electronic problems.

EPFO System Problems

- *Coverage*: on average, it takes 2 months to issue an Employer ID number. When an employee changes jobs, he/she is issued a new number and must start to accrue from zero.
- *Contributions*: EPFO is several years behind in posting contributions which affects its ability to monitor compliance
- *Accounting:* EPFO uses a single –entry cash accounting system. Also, it does not always know from whom money has been collected, or to whom money belongs.
- *Claims*: Claims processing often takes weeks or even months.

The single-entry cash accounting system currently used by EPFO does not conform either to Indian accounting standards, international accounting standards (IAS), or to U.S. Generally Accepted Accounting Principles (GAAP) standards. Using a universally understood and accepted set of standards for the presentation and treatment of financial statements promotes transparency and enables investors to accurately determine the financial health of a corporation or organization. *As capital markets in India develop, workers till have a variety of pension plans and investment options from which to choose. In order to compete effectively with other investment alternatives, EPFO must treat its accounts and present its financial statements in an accurate, reliable and transparent manner.* The Siemens Co. team that is currently working with EPFO is examining accounting related issues. Depending on the specific scope of their activities, additional assistance could be provided by USAD in international accounting standards.

EPFO is committed to improving its systems and customer service – therefore, the criterion of the presence of a 'champion' is met. Additionally, this proposed intervention fits with USAID's overall country objectives, and USAID possesses a comparative advantage in undertaking this intervention, as it has implemented similar programs (particularly in IAS) in other countries and has access to experts who can design and implement appropriate systems. Finally, and most importantly, benefits far exceed costs; investing the resources to undertake this intervention will reap high rewards. The results of installing an accurate and efficient system that is capable of taking on larger volumes as EPFO membership grows include: (1) reduced turnaround times on claims processing, (2) ability to accurately track contributions and benefits, which will help ensure financial sustainability of EPFO programs, (3) improved compliance, and (4) increased customer service. Improvements in customer service will generate higher levels of participation in EPFO programs, which, in turn, will facilitate a build-up of funds and will contribute to the long-term financial sustainability of EPFO programs.

Cost:
Costs would include technical assistance to be provided by a long-term Operations/MIS/IT Team Leader for approximately one year, and a long-term records management expert for approximately one year. Additional costs would include technical assistance to be provided by a short-term resource pool of experts. These may include experts in corporate governance, compliance and corporate governance, financial analysis, privacy and security of records, etc. Depending on nature of the intervention, other costs could include training, implementation, etc.

Total costs are estimated at $1 million over one year.

Intervention #8: Design and Implement Civil Service Pension Reform Program

Description:
The purpose of this intervention would be to design and then implement a civil service reform program. It would be undertaken in two phases. Phase 1 would be one year in duration and would focus on program design. Once the costs and benefits of various options are determined, a pension policy Team Leader would work with the Indian lead agency/ies (Ministry of Personnel and the Ministry of Finance) on program design issues. These include: type of program (defined benefit, defined contribution, other), eligibility requirements, amount of contributions,

investment guidelines (including prudential regulations, licensing norms for intermediary, depending on type of investment structure), regulatory oversight structure, enforcement and supervision, risk management (capital adequacy, liquidity), disclosure, ongoing actuarial analysis, and records-keeping, accounting, financial management, etc. A resource pool of short-term experts who would provide specialized assistance in these areas would support the Team Leader.

Phase 2 will focus on actual implementation of the program, and would commence once the type of program has been decided upon. This phase would be approximately 2 years in duration. A long-term operations/MIS/IT expert would design an appropriate system and implementation action plan. This system must be able to track collection of contributions, allocate contributions to investments, pay benefits, and maintain records on participants, and monitor compliance, and track financial performance. The pension policy Team Leader would provide support as needed.

Other activities to be conducted by the team would include conducting a skills assessment of staff who will be responsible for administering the system and overseeing regulation, and developing and implementing a training program to build capacity of these staff. In addition, information dissemination and consumer education programs would need to be developed and implemented.

Rationale:

This is both an urgent and high priority. Unfunded liabilities are large and are projected to increase rapidly in the future, representing a huge financial burden on the central government budget. Further, the Ministry of Finance has mandated that, as of October 2001, all new recruits into the civil service will not be eligible for pensions under the existing unfounded system; they must be covered under a new funded pension program. This program has yet to be designed. Therefore, the need is urgent and the financial impact is enormous. However, the task is not easy and cannot be done quickly. The intervention does fit with USAID's objectives and comparative advantage. *The results of this intervention would be a financially sustainable pension program for civil servants that provides adequate old age income, and a substantial long-term decrease in government pension liabilities.*

Government Pension Outlays as % of GDP

YEAR	% OF GDP
1990-91	0.61
1994-95	0.57
1999-0	1.00
2000-01	0.96
2001-05	0.75%
2009-10	0.47%

Cost:

Phase 1 costs would include technical assistance to be provided by a pension policy Team Leader, as well as short-term technical assistance to be provided by a resource pool of experts on an as needed basis during Year 1.

Phase 2, to be conducted over years 2-3, would include technical assistance to be provided by an operations/MIS specialist, either intermittent or full-time technical assistance to be provided by the pension policy Team Leader from Phase 1 (depending on need), and short-term technical assistance by the resource pool of experts on an as-needed basis. Other directs costs such as travel, per diem, etc. would also be included.

Total cost are estimated between $2-4 million over 3 years, of which Phase 1 is estimated to cost about $1million for Year 1, and Phase 2 is estimated to cost $1-2 million for Years 2-3 (depending on how much assistance is provided in training staff, installing systems, etc.).

Summary of Recommended Interventions

In summary, the Team's recommendations offer USAID a comprehensive, integrated and broad range of opportunities for intervention, including opportunities to:

- Get involved in a broad range of issues at both strategic and operational levels including: working directly with the Government in providing strategic advice and shaping overall policy reform (Intervention #4); designing specific pension programs (Intervention #8); engaging in capacity building, advocacy, and outreach (Intervention #2); upgrading accounting, compliance/corporate governance, and records-keeping (Intervention #7); and developing inter-Ministerial IT and data collection systems (Intervention #5)
- Intervene at several funding levels depending on resource constraints. Recommendations include those estimated to cost less than $1 million, $2-4 million, and $5-10 million
- Undertake short-term interventions that yield immediate results, as well as interventions that require a deeper and more sustained level of involvement, yielding broad and lasting results

Pension Reform v. Capital Markets Reform

There are significant synergies between USAID's current capital markets reform efforts (the FIRE project) and potential future interventions in pension reform. On one hand, EPFO and other pension and provident funds control large amounts of money that can be channeled into private sector development through India's capital markets. On the other hand, these pension funds need a robust and well-regulated capital market in which to invest. Moreover, the knowledge and experience that USAID has gained through the FIRE project can help ensure the success of pension reform efforts. Despite these synergies, however, we would recommend that any pension reform initiatives be kept separate from the FIRE project, for three reasons:

1. *Different objectives:* The FIRE project aims to strengthen and expand India's capital markets. A pension reform initiative, in contrast, must have old age income security as its primary objective. *While a national pension system should support (or at least not hinder) economic growth, this objective should always be secondary to the needs of its members*. Folding pension reform into the FIRE project might risk compromising this objective and losing visibility.
2. *Distinct focus:* The pension reform assistance program we have proposed is fairly large and complex, and will require focused management attention from a USAID CTO. The chief counterpart agencies are all located in Delhi, while FIRE works out of Mumbai. Folding the pension reform effort into FIRE would complicate management of pension reform, and could distract the current FIRE team (USAID and the contractor) from their primary work in capital markets reform.
3. *Access to resources:* The recommended pension reform program (or any single intervention in pensions) will require skills, experience and resources that are different than those employed by FIRE. If the pension reform program were folded into FIRE, it might be difficult to obtain access to specialist resources such as pension regulatory experts, actuaries, systems specialists and plan administrators through the FIRE contracting arrangement.

For these reasons, we believe that while the two efforts should certainly be well coordinated, pension reform warrants a separate focus and should be managed independently of the FIRE project.

6.4 Implementation Action Plan

USAID can of course decide to pursue none of the recommended interventions, some but not others, or all of them, depending on its strategy and resource constraints. The total cost of pursuing all five recommended options would total less than $20 million over 5 years, with about $7.5 million of this amount occurring in the first two years. (It should be noted, however, that these cost estimates are very general and may change substantially as detailed Terms of Reference are developed for each intervention). Since the total estimated expenditure for all 5 recommended interventions falls within the parameters set for us by USAID, we have prepared a high-level implementation "roadmap" that incorporates all 5 initiatives.

The chart on the following page illustrates the proposed timing and sequencing of the recommended interventions. The chart suggests several key points to keep in mind in designing a comprehensive, integrated program of pension reform assistance:

- *Intervention #4 (Provide Ongoing Assistance to PRTF and Pensions Regulator)* would provide USAID the opportunity to take a leading role in helping to set direction for and coordinate the implementation of India's process of pension reform. It would also provide a mechanism for coordinating and overseeing other, more operational-level initiatives. By providing a clear link into India's key decision-makers, undertaking Intervention #4 could help ensure the success of other interventions.

- *Intervention #5 (Design and Implement Universal ID System)* will need guidance and support from the PRTF to be effective, as it requires a great deal of cooperation across various government ministries and agencies as well as a substantial investment on the part of the Government. Phase 1, focusing on project concept, design and planning, could begin immediately.

Procuring Technical Assistance for Pension Reform

USAID may wish to utilize an existing IQC mechanism, such as SEGIR Financial Services, to procure technical assistance for its pension reform efforts in India. Doing so would streamline the procurement process and allow USAID to put consultants in the field more quickly, without compromising access to specialist resources or flexibility in project design and procurement. Under SEGIR FS, for example, a number of highly-qualified contractors have already been pre-approved based on their credentials in pension reform and related areas, and are subject to agreed-upon rates and allowances. Using an IQC like SEGIR FS to procure technical assistance would allow USAID to respond to India's urgent needs more quickly and efficiently.

- *Intervention #2 (Create Indian EBRI-Type Institute)* can begin immediately, as it does not require the establishment of PRTF to be set up.

- *Intervention #8 (Design and Implement Civil Service Pension Reform Program) and Intervention #7 (Upgrade EPFO Records Management Systems)*, can also likely begin immediately. The Indian Government has already committed itself to creating a new, funded pension program for civil service and has begun (with USAID assistance) to examine plan design options. Given the existing momentum, it would make sense to continue this process without interruption. Similarly, EPFO has already launched an internal re-engineering effort and recommendations have been made regarding its records management and accounting procedures. Again, USAID can best help ensure the success of these efforts by providing assistance as soon as possible. Neither Intervention #8 nor Intervention #7 requires the PRTF to be operational in advance.

This integrated assistance program, consisting of the five interventions seen below, can be substantially completed with demonstrable results well within a five-year timeframe.

Potential USAID/India Pension Reform Initiatives: Preliminary Roadmap

4. Provide Ongoing Assistance to PRTF and Pensions Regulator

- One long-term advisor with "resource pool" of short term advisors/trainers
- 2 to 3 year timeframe and likely cost about $2.5 -3 million
- LT Advisor acts as coordinator / liaison for other interventions

8. Design and Implement Civil Service Pension Reform Program

- Small team to help design and launch new, funded pension program
- Phase 1 (Design) is 1 year and Phase 2 (Launch) is 2-3; likely cost about $2 – 4 million
- Phase 2 can be made contingent on Phase 1 results

2. Create Indian EBRI

- 1-2 short-term advisors, possible study tour to EBRI
- 9 - 12 month timeframe and likely cost about $500,000 to $1 million
- Cost depends on size/length of study tour or exchange with EBRI

7. Upgrade EPFO Records Management

- 1 LT Operations/MIS/IT Team leader, 1 LT Records Management expert, and short-term advisors
- Estimated cost is approximately $1 million, over one year
- Could be undertaken simultaneously with upgrading of civil service records mangement

5. Design and Implement Universal ID System

- Concept/Design Phase: 1 Team Leader with short-term resources to design system
- Optional Implementation Phase: could include data collection, IT installation, testing and data analysis
- Concept Phase likely cost is $500,000 - 1 million over 1 year; Implementation Phase can be $5-10 million depending on scope, over 3 years

Year 1 | *Year 2* | *Year 3* | *Years 4 - 5*

7 CONCLUSION

The five recommended interventions together represent a comprehensive program of pension reform assistance. We believe that it would be both feasible and desirable for USAID to pursue all five interventions. This would generate substantial benefits both for India and for USAID:

Benefits to the Government of India – Why USAID Should Support India's Pension Reform Efforts
• *Grant Funding:* USAID is in a unique position among donors in that it can provide substantial grant (as opposed

to loan) funding; if USAID provides the recommended assistance, GOI can better achieve ambitious pension reform objectives without incurring large debts in addition to its existing pensions burden.

- *Pensions Expertise:* USAID, again uniquely among donor agencies, can provide access to a wealth of experience and expertise in pension reform, as a result both of its experience in other countries (Bulgaria, Hungary, Poland, etc.) and its relationships with US-based pension specialists through its contractors and other agencies such as EBRI, the Academy of Actuaries, PBGC and others. By leveraging USAID's network of expertise, GOI can learn from the experience of others and avoid past mistakes.
- *Track Record in India:* USAID, while new to India's pension reform process, has successfully managed the large-scale FIRE project for several years, gaining valuable experience in building consensus among disparate public and private sector entities, solving complex problems and achieving meaningful reforms. This experience can help ensure the success of India's pension reform process as well. Moreover, while USAID pension reform efforts should be managed separately from FIRE (see earlier text box), there can be significant "synergies" between the two initiatives. Ultimately, funded pension programs will need a robust, well-regulated capital market in which to invest. Conversely, India's capital markets can benefit from the financial resources and governance that active pension funds can bring to bear.

Benefits to USAID – Why USAID Should Pursue an Integrated Assistance Program

- *Complementarity:* Pursuing an integrated assistance program gives USAID more control over the outcome of its efforts. If USAID were to pursue a more limited program, for example only upgrading EPFO records management or only helping to establish a unique ID system, the ultimate impact of these interventions could be subject to PRTF's progress in creating a suitable regulatory framework and improving plan design – elements over which USAID would have no influence. Conversely, if USAID were only to assist the PRTF and not engage in more operational-level initiatives, the impact of its efforts would be subject to the capability of agencies like EPFO to carry out recommendations. By working simultaneously at both the "strategic" and operational levels, USAID can best ensure that its assistance program will result in lasting improvements to India's pension system.
- *Near-Term Results Combined with Long-Term Direction:* Like most donor organizations, USAID has a responsibility to demonstrate tangible, measurable results in the near- to medium-term. USAID is also concerned with longer-term efforts like institutional capacity building and developing a robust policy and regulatory framework for pensions. An integrated assistance program like the one we have recommended would allow USAID to combine these objectives. Establishing an Indian EBRI, designing a new civil service pension program and upgrading EPFO records management are designed to demonstrate tangible results in the near-to-medium term, while providing ongoing assistance to PRTF and planning for a unique ID system will lay the foundation for the long-term success of India's pension reform process.
- *Support for Strategic Objectives:* An integrated assistance program would allow USAID to meet its strategic objectives of fostering private sector growth, reducing poverty and building institutional capacity. Pension reform is a critical area for India, involving a vast amount of money and complex decisions that affect the lives of millions. As the population ages, pension reform will become increasingly important. We believe that a substantial, integrated assistance program in this area represents an effective use of USAID resources.

In summary, pension reform is a critical area for India and USAID is well placed to provide some of the assistance that the country needs to make its reform efforts successful. *Expenditures on pensions now accounts for nearly 15% of central government tax revenues,* and this number will rise quickly as India's population ages over the next decade. Scarce government resources that could be spent on more targeted poverty alleviation programs or needed infrastructure projects instead go to pay the pensions of retiring civil servants. At the same time, hundreds of millions of Indian workers have little or no old age income security. *The EPF, subject to strict investment guidelines, places more than 400 billion Rupees in member contributions exclusively in public sector securities, thus "crowding out" a great deal of private investment and* *hampering the growth of India's capital markets.* The problems facing India's pension programs are serious and growing worse. Whether and how these problems are solved will have a very substantial impact on the country's long-term economic development. For these reasons, we believe a relatively aggressive program of assistance is certainly warranted.

USAID is perhaps the only donor organization that can provide India with the pension reform assistance that it needs. Successful pension reform will require an integrated effort sustained over a number of years. This effort will cost money – money that the Indian Government may not find it easy to repay if it comes in the form of loans. The effort will also require access to a broad range of international expertise – which USAID can provide. Lastly, USAID can assist the pension reform process by applying the lessons learned through its successful FIRE program – few, if any, other donor agencies have successfully managed such a large-scale and complex assistance project in India. India's patchwork pensions system is clearly a major obstacle to sustainable economic development, and USAID has the resources and experience to help India overcome this obstacle. For these reasons, we believe USAID should invest substantially in an integrated program of pension reform assistance.

In closing, we wish to thank USAID for giving us the opportunity to contribute towards the Mission's objectives and we hope that our Report will help the mission develop an effective and ultimately successful assistance program.