PENSIONS IN INDIA

THE NEW PENSION SYSTEM

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BACKGROUND INFORMATION

Rationale of Pension Reform in India

- "Welfare state" ideology
- People do (did) not save to provide old age income for themselves
- Government sponsorship of a large part of pensions
- Pension payments constitute enormous chunk of government expenditures
- The strain on governmental revenues for pension payments escalates greater and faster than GDP
  - quality of health care and life span improve, so is the number of elderly.

The Indian Workforce

(Source: India's Pension Reform Initiative, by D Swarup, Chariman, PFRDA, Public Audit and Accountability, Vol 1, April – June 2007)

Organized Sector	Unorganized Sector	Estimated Total Workforce
118 million	307 million	425 million
		Of which, about 50 million, or 12%, of this number are covered with some form of pension arrangement.

Need for Pension Reform in India

- ***Current pension system in India***
  - ***Predominantly Defined Benefits***
  - ***Low coverage/benefit***
  - ***Under performance of Provident Fund schemes***
  - ***Investment restrictions***
  - ***Administrative difficulties***
  - ***Underdeveloped private annuity market***
  - ***Increase in the informal workforce***
  - ***Widening disparity of pensions between public and private sector employees.***
  - ***Fragmented regulations (mostly unregulated)***

Need for Pension Reform in India

- ***Urgency to reform the pension system***
  - ***Reduce government burden (the number of persons aged 60 and above would exceed 110 Million by 2016).***
  - ***Ease the strain on governmental revenues - payment of pensions is one of the largest components of government expenditures.***
  - ***Incentivize unorganized labor sector to save for old age income security***
  - ***Barely 12% of working population participate. Almost 90% of India's workforce not saving any for their old age income.***

Need for Pension Reform in India

- ***First steps***
  - ***Adopt Defined Contribution (DC) schemes – veer away from DB***
  - ***Introduce private pension = large-scale mobilization of savings***
  - ***Funding of pension liabilities***
  - ***Provide participants power of choice:***
    - ***among competing pension fund managers,***
    - ***growth type or secure income type of investment schemes,***
    - ***flexibility to plan and program pension savings,***
    - ***freedom to choice would be the best agent to manage his money.***

These options do not exist under the old system where funds remain under the administration by the government or pension fund organizations not subject to regulatory oversight..

CURRENT PENSION SYSTEM

- ***Classes of India's current old age income security schemes***
  - ***Mandatory schemes for civil service employees***
  - ***Voluntary Pensions***
  - ***National Old Age Pension***

CURRENT PENSION SYSTEM
TYPES OF PENSION SCHEMES IN OPERATION

(*Source: India's Pension Reform Initiative, by D Swarup, Chariman, PFRDA, Public Audit and Accountability, Vol 1, April – June 2007)*

Category	Type of Scheme	Est. number of covered Employees	Year Established	Management Administration
Civil Service Pension	DB – pay as you go – 50% of the final average wage earned during the last 12 months	12 Million	NA	Government
Employees Provident Fund	DC – contributions + interest upon retirement, resignation or death	40 Million	1952	EPFO Private Provident Funds
Employees Pension Scheme	DB – retirement, disability or death	28 Million	1955	EPFO
Special Provident Fund		2.1 Million	NA	Government
Public Provident Fund	Voluntary for the unorganized sector	3.5 Million	NA	Government
NOAPS	Fixed monthly payment (unfunded, pay-go)		NA	Government
New Pension Scheme	*DC – Individual Accounts*	*.5 million, growing*	*2004*	*CRA, Private PF and POP*

CURRENT PENSION SYSTEM

TYPES OF PENSION SCHEMES IN OPERATION

- ***In addition, by law, workers in both public and private sectors receive a lump sum gratuity at retirement.***
  - ***subject to certain eligibility conditions.***
  - ***Benefit is equal to 15 days of final earnings for each year of service***
  - ***Maximum of Rs. 350,000 (more or less, USD 10,000)***
  - ***100 % paid by employer***
- ***Tax regime: EEE up to certain amount of annual contribution***

THE NEW PENSION SYSTEM (NPS)

Essentially, Defined Contribution

- ***Participation/Coverage:***
  - ***All Central Government workers recruited from 1 January 2004***
  - ***All workers of State Governments recruited from date the State Government's notification of adopting the NPS***
  - ***All voluntary pension arrangements***

THE NEW PENSION SYSTEM (NPS)

Fundamental Features/Mechanism

- ***Segregation of:***
  - ***Record Keeping (Central Record Keeping (CRA)***
  - ***Fund Management (PF)***
- ***Point of Presence (POP) entities authorized to provide pension arrangements)***
- ***Individual Accounts***
- ***Portability***
- ***Full Funding of pension liabilities***
- ***Regulated Pension (Oversight)***

THE NEW PENSION SYSTEM (NPS)
Pension Oversight

- **Dec. 2004 – the Pension Fund Regulatory and Development Authority (PFRDA) was created by Ordinance of the Government of India.**

- **Mar. 2005 – the PFRDA Bill was introduced at the Central Government Parliament**
- **2007 – Proposed Regulation**

  Expected to be promulgated by the PFRDA upon the passage of PFDRA Act.

- **Risk Based Supervision Approach**

THE NEW PENSION SYSTEM (NPS)

Pension Oversight – Salient Features

- **Statutory Capital Requirements, Fit and Proper Norms, among others in:**
  - *Registration and Licensing of Central Recording Agencies (CRA)*
  - *Registration and Licensing of Pension Fund (Managers)*
  - *Registration and Licensing of Point of Presence (Authorized Pension Providers such as Banks, Financial Institutions, Mutual Funds, Insurance Companies)*
- **Continuing Capital and Surplus – tied to amount of accumulated pension liabilities**
- **Prior Regulatory Approval, among others, of:**
  - *Terms and Conditions of the Pension Scheme*
  - *Service Agreements between and/or among CRA, PF and POP*
  - *Service fees charged against fund contribution and/or accumulation*
  - *Declaration and payment of dividends to shareholders*

THE NEW PENSION SYSTEM (NPS)
Pension Oversight – Salient Features

- ***CRAs, MFs and POPs required to meet certain criteria of performance in managing pension risks, such as***
  - ***Investments (norms, quality, diversification, etc)***
  - ***Corporate Governance Standards***
  - ***Protection of the Interest of Participants and Beneficiaries***
  - ***Valuation of pension assets and liabilities***
  - ***Regulatory submission, form and frequency, of financial reports***
  - ***The form, timing and manner of sending Individual Account Statements***
  - ***Disclosure norms***
  - ***Accounting principles and standards***
  - ***Financial reporting standards***
  - ***Training, licensing and continuing education of agents or intermediaries soliciting pension fund business***

THE NEW PENSION SYSTEM (NPS)
Challenges

Will the NPS …..

- ***Broaden and deepen the reach of pension products across all sectors***
- ***Increase financial literacy levels of older populace***
- ***Promote design & distribution of pension products that address gender and economic status of women***
- ***Offer acceptable alternatives to pensions under the old pension system***
- ***Counter the mindset of middle aged income earners who heavily depend on family transfers at retirement rather than starting savings at somewhat late stage***
- ***Provide meaningful amount of retirement income***
- ***Create awareness to build the confidence of the people at large***
- ***The voluntary nature of the NPS attract large scale participation***
- ***Bring about dynamic regulations balanced towards promoting optimization of investment returns for healthy growth of pension assets***

Thank you!