Changing the Way India thinks Tomorrow

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There are many explicit and implicit benefits to be derived from NPS. Its long term benefits will be huge, impacting every aspect of social and economic life of the nation

ONE OF the basic goals of a social security system is to provide a secure and broad based source of old age income. Active ageing is a right of every citizen who has contributed to the growth and development of a nation while they were young and working. However, while providing for their old age, a nation also has to keep in mind the resources it has at its disposal.

Improved living conditions and better medical services have resulted in increased longevity for people. This has created imbalance in the ratio of workers to social security beneficiaries, putting a question mark on the sustainability of the existing models of pension. Therefore an intense debate has been going on the world over about right type of pension reform models.

Three main reform models have emerged in the process - **Parametric Reforms, Systemic Reforms and Notional Defined Contributions.** While the implicit objective of all these reforms is to enhance pension entitlement, the difference pertains to the entities who would shoulder the Longevity Risk. In the parametric reforms the risk is born by the pension providers while in case of systemic reforms longevity risks are transferred to the pensioners through a shift from Defined Benefit (DB) system where pension benefits are given as per a pre defined formula, to Defined Contribution (DC) systems where contributions are paid into an individual account for each member, these contributions are invested, for example in the stock market, and the returns on the investment (which may be positive or negative) are credited to the individual's account. On retirement, the member's account is used to provide retirement benefits. The Notional Defined Contribution reforms integrate some characteristics of DB and Dc systems.

What was wrong with the Indian Pension System ?

Demographic Trend

Life expectancy has been steadily increasing and is estimated

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to go up from 63.7 yrs at present to 67 yrs for male and 68.8 yrs for female in 2016. The Growth Rate of elderly population in India is 3.8% as against general population growth rate of 1.8%. and the number of elderly population will be more than double in the next 20 years. This is steadily adding to the pressures on government exchequer.

Low Coverage

The current social security and pension system mainly covers the organized Civil Service, public sector and some segment of organize private sector. The bulk of labour force working in the unorganized sector have no such cover. It has been estimated that , only 11% of workers are covered by formal pension system while 89% still remain uncovered.

High Cost Defined Benefit Pension

The Defined Benefit pension for the organised segments of government service seems to be unsustainable in the future as it is exerting a lot of pressure on government exchequer.

Pension Assets

India is still much behind the developed and many emerging countries in terms of her pension assets. In 2005 India's p ension assets percentage of GDP was only 5.3% as against 64.9 percent for Chile, 62.6 percent for Singapore, 56.7 percent for Malaysia , 33.9 percent for South Africa, 125 percent for Netherlands, 99 percent for USA and 66 percent for UK.

India therefore needed to introduce a pension system that would be able to face the above challenges, and thus came the contributory and funded New Pension System in January 2004, which came into effect from May 2009.

NPS : Structure

The NPS is a distinct system, close to Systemic Reform. India has retained its existing DB system for civil servants and also allowed the EPFO and other statutory pension/ provident fund system like EPF, EPS etc. to continue, but made the NPS mandatory for central government employees who joined services on or after 1st January, 2004. It is also voluntarily applicable to all citizens of India making the reform distinct from many countries which have initiated pension reforms in the recent times.

The Individual Account based NPS is a Two Tier system:

Tier -1 : is Mandatory Non Withdrawable Pension Account. The employees will contribute 10% of their salary and an identical matching contribution will be made by the Government , totalling 20% contribution to the pension account of the employees.

Tier-2- is Voluntary, Withdrawable Savings Account. No contribution will be made by the Government.

Individual Account Number : Every subscriber will be issued a unique Permanent Retirement Account Number (PRAN) by the Central Record keeping Agency (CRA).

Portability : NPS is Portable and the pension benefits will never cease even if the pensioner moves from one place to another. Subscribers will also be entitled to switch over from one scheme to another scheme as well as from one Fund Manager to another Fund Manager.

Multiple investment options: The Pension Fund Managers will offer multiple schemes to the subscribers .At present, schemes offered to the central government employees and other citizens are different.

Funds offered to Central Govt. Employees : There are two Schemes , Scheme-1 : under which 85% assets are invested in debt instruments and 10% assets to be invested in Equity Mutual Funds/ Corporate Bonds and 5% assets to be invested in Equity. Under Scheme-11 , 100% pension assets will be invested in Govt. Securities. However at present only Scheme I is operational.

Funds offered to All Citizens (other than Central Govt. Employees) : One of the most significant feature of the NPS is flexible investment option. One can select a scheme depending oh her/ his risk tolerance capacity from a basket of three schemes under active choice. These include Asset Class E : Investment in predominantly equity market instruments; Asset Class C : Investment in Fixed income instruments other than the Govt.Securities; Asset Class G : Investment in Government Securities. However those who are unable to decide any scheme by themselves, can simply opt for a pre determined investment portfolio called Auto Choice.

Pay outs in NPS

Two different types of pay out mechanisms have been introduced under NPS :

For Central Govt Employees: At the time of retirement when accumulation period ends an employee has the option to invest at least 40% accumulated wealth in purchasing an annuity plan from a life insurance company approved by IRDA and to take maximum 60% of as lump sum withdrawal.

For all citizens : Voluntary NPS allows an investor to withdraw before age 60 at any point of time but he has to invest at least 80% of accumulated wealth to purchase an annuity from a life insurance company approved by IRDA and 20% as lump sum withdrawal. However, when an investor exits at the age 60, he has to invest at least 40% of wealth in annuity and the remaining amount can be withdrawn as lump or as a phased withdrawal between the age 60 and 70 . This Phased withdrawal is an additional facilities in voluntary NPS.

NPS : Cost

NPS is one of the low cost pension systems in the world. The cost structure is also very transparent. Various charges under NPS shown below :

As the number of accounts in CRA increase to 10 lakh, and then to 30 lakh, the service charges, (exclusive of Service Tax and other taxes as applicable) will be reduced to Rs. 280 and Rs 250 respectively for annual PRA maintenance per account and to Rs . 6 and Rs 4 respcetively for charges per transaction.

Tax Benefits: There are tax benefits for participating employees. Currently EET Tax is applicable for mandatory contribution to NPS.

NPS : Architecture

NPS has a well thought out architecture with defined role of various entities:

Pension Fund Regulatory and Development Authority (PFRDA)

The PFRDA has the responsibility to regulate and develop the pension market in India. This includes carrying out regulatory changes, overseeing quality and provision of services of NPSCAN, CRA, PFs Trustee Banks etc.

NPS Trustee

An NPS Trust has been set up by PFRDA for taking care of assets and funds under the NPS. The securities shall be purchased by the PF(s) on behalf of and in the name of Trustees and the securities purchased by each PF shall be held in the Custodial Account of NPS Trust. However , Individual subscriber shall remain beneficial owner of these securities assets and funds. NPS Trust will appoint Trustee Bank and hold an account with it.

Central Record Keeping Agency (CRA):

CRA would undertake Record Keeping, Administration and Customers service, issue of unique Permanent Account Number (PRAN) to each subscribers, maintaining a data base of all subscribers, and recording transaction relating to each subscribers. National Securities Depository Ltd (NSDL) has been appointed as the CRA for the NPS.

Pension Fund Managers : In order to introduce competition and to provide wider choice to the subscribers , PFRDA has allowed

Intermediary	Charge head	Service charges *	Method of Deduction
Central Record Keeping Agency (CRA)	PRA opening charges	Rs. 50	Through cancellation of units
	Annual PRA Maintenance cost per account	Rs. 350	
	Charge per transaction	Rs. 10	
Point of Presence (POP0) (Max. Permissible Charge for each subscriber)	Initial subscriber registration and contribution upload	Rs. 40	To be collected upfront
	Any subsequent transactions	Rs. 20	
Trustee Bank	Per transaction emanating from a RBI location	Zero	Through NAV deduction
	Per transaction emanating from a non-RBI location	Rs.15	
Custodian (On asset value in custody)	Asset Servicing charges	0.0075% p.a for Electronic segment & 0.05% p.a for Physical segment	Through NAV deduction
PFM charges	Investment Management Fee	0.0009% p.a.	Through NAV deduction

multiple fund mangers. The subscriber will have a choice to select from multiple pension fund managers and multiple schemes. Pension Fund Managers will manage investment of Retirement Savings of NPS. There will be no implicit or explicit assurance of benefits except market based guarantee mechanism to be purchased by the subscriber. PFRDA has appointed three pension fund managers, namely LIC Pension Fund Ltd., SBI Pension Fund and UTI Securities Ltd for managing funds of Central Govt. employees who will also manage State Govt Funds. Further, PFRDA has appointed six fund managers to manage funds of all citizens (excluding Central and State Govt Fund).

Point of Presence (POPs) :

PFRDA has appointed 22 POPs who will act as collection centre for NPS , will collect application forms from the subscribers (under All Citizens category) and send the same to the CRA.

Trustee Bank :

The Trustee Bank will maintain the account of the Trustee and will receive credits from the government department or its agencies and transmit the information to the CRA for reconciliation. The Trustee bank shall remit the funds to the Pension Fund Managers, Annuity Service Providers (ASP). NPS Trust has appointed Bank of India as the Trustee Bank

Custodian :

The Custodian will provide Custodial Services to the Pension Funds, which will include among others to ensure that benefits due on the holdings are received, provide detailed reports to the PFs etc. NPS Trust has appointed Stock Holding Corporation of India Ltd as the custodian for the new pension system.

Annuity Service Providers (ASP):

The role of annuity service providers (ASPs) will be critical in the NPS, since they will offer annuity to the subscribers when members reach superannuation or withdraw pension assets. As per the provision there would be mandatory annuitization, and the members have to purchase annuity from ASPs. The ASPs will offer annuity products to the subscribers, receipt funds from CRA and pay regular monthly annuity.

NPS : Impact

Introduction of Funded Defined Contribution pension system will have a far reaching impact on Indian society and economy.

Extend coverage :

NPS will not only extend the necessary pension coverage and retirement income to those who at present do not have any access to formal social security/ pension . but will also spread financial literacy and induce the citizens to save for old age income through regular savings while they are earning. .

Increase Savings, Investment and Growth :

NPS would have far reaching impact on domestic savings , since a member of NPS needs to contribute on a continuous basis for a long time, normally till the age of 60 years . This would boost up savings for long term investment . India is already in a high growth trajectory and enhanced domestic savings would support investment activities and macro economic growth.. Research have indicated that Pension Reforms have boosted up GDP growth rate in Chile and other countries, induced domestic savings rate and significantly influenced the Capital market.

Capital Markets :

Pension Funds are very active Financial Intermediaries . Pension reforms will increase the retirement assets , which are required to be invested in debt and capital market thus supporting the capital market activities. Further the emerging pension industry will increase the demand for long term financial instruments like Inflation Index Bonds, Zero Coupon Bonds etc. which will lead to financial innovation. A well developed Pension market thus provides stability to macro economy and financial market.

Life insurance and Annuity Market :

India has adopted the third option – Mandatory Annuitization . Under the NPS, it is mandatory that at least 40% of Pension Wealth will be invested in life Annuity at the time of superannuation. The Annuity Policy will be purchased from one of the Life Insurance Company approved by the Insurance Regulatory and Development Authority (IRDA), which will provide a boost to the life insurance annuity business in India.

We have mentioned about a few visible and explicit benefits of Pension Reforms through NPS , but there are many more explicit and implicit benefits to be derived. Long term benefits of NPS will be huge, impacting every aspect of social and economic life of the nation. ❑

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