PENSION REFORMS – A CRITICAL APPRAISAL

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INTRODUCTION

- 'Pension Reform' – not avoidance of the problems of Old Age Provision
- Advocated Solutions - Result into reduction of pension benefits available on retirement or on happening of other contingencies leading to cessation of income
- 'Old Age Provision' should be on top of the Compensation Menu if we do not wish to create a class of elderly destitutes
- OASIS report absolves the state of any responsibility towards unorganized sector which has high proportion of Below Poverty Line families
- NPS is no answer to the problem. It visualizes entire paraphernalia of functionaries like 'Points or Presence', 'Fund Manager' and so on which is like creating a reservoir without identifying sources from which the water will flow.

Contd.

- Mathematics of Finance is fascinating-

  Even if a beggar were to save one rupee per day, he will have pension corpus of Rs. 37,660 in 25 years time assuming return of 10% p.a. But since he will go hungry, it is doubtful whether he will survive for 25 years.

  Expectation of life in respect of families Below Poverty Line could be significantly lower.

- Problems of Old Age Provision in developed countries is aggravated on account of improvement in longevity, but in India it would be wrong to think in terms of one figure of expectation of life. There are not only large regional disparities but even within a region, the expectation of life would vary significantly according to economic and social classification. This aspect is important in view of wide inequalities of income.

- Living longer is not bad in itself if people are able to engage themselves in gainful economic activity over a longer life span. Retirement age has increased from 55 to 60 years and may go up to 65 years thereby reducing the burden of dependency.

Defined Benefit Plans (DB)

vs.

Defined Contribution Schemes (DC)

- To accept that Defined Benefit Pension Plans are unworkable is tantamount to rejecting the actuarial doctrine which is all about quantification of future uncertain events including financial and economic events. With annual actuarial valuations, stakeholders can have the benefit of course correction before disaster falls upon them.

- Defined Contribution Schemes have not only resulted in transfer of investment risk and inflationary impact on the shoulders of the employees, but it has also effectively diluted the pension promise and made the pension promises unpredictable and unsuitable in terms of the very objective of providing pensions viz., to protect the living standards after retirement.

  This is exactly what the NPS has done to civil servants in India and that may be the fate of benefits under EPS, 1995.

ILLUSTRATION

On the basis of the following assumptions we have compared the above plans in terms of annual pension as a percentage of final salary:

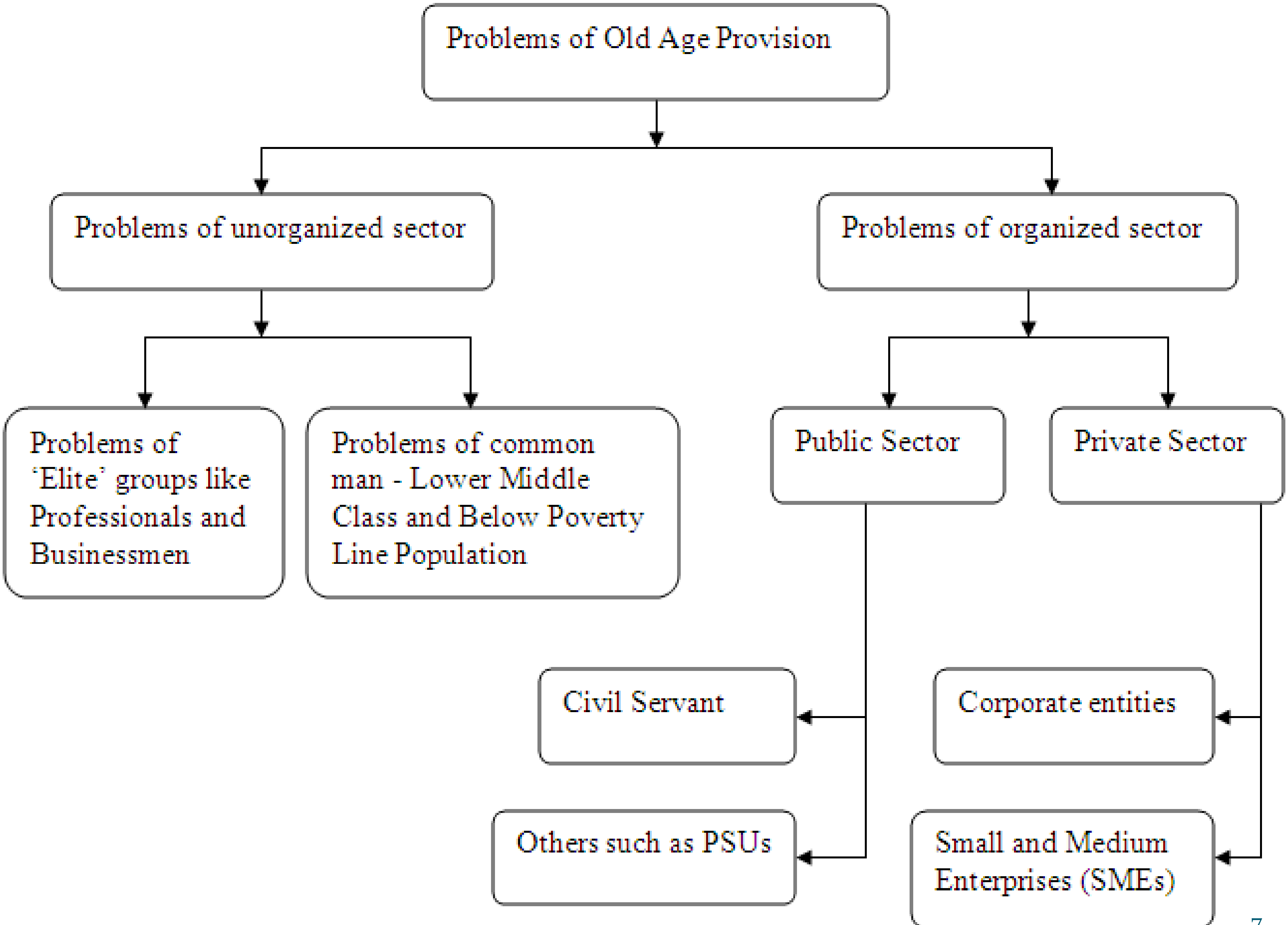
Retirement Age	60 years
Discount Rate	8.00%
Salary Escalation Rate	7.00%
Expected Returns on Assets	8.5%
Contribution (employers - 10% + employees – 10%)	20%
Entry Salary	Rs. 100
Annuity Rate per Rs. 1,000 pension corpus (as per LIC Annuity Rates)	Rs. 93.5
Annual Accretion of 1/60th of length of service subject to a maximum of 50%	

Contd.

Entry Age	DB Plan			DC Scheme		
	Projected Annual Pension	Annual Cost as a % of annual salary	Pension as % of final salary	Projected Annual Pension	Contribution rate	Pension as % of final salary
20	748.72	33.46%	50%	407.77	20%	27.23%
25	533.83	34.24%	50%	282.36	20%	26.45%
30	380.61	35.83%	50%	192.94	20%	25.35%
35	226.14	32.09%	41.75%	129.18	20%	23.80%

Let's consider an employee with an entry age of 25. In case of DB Plan, even if it is a non-contributory plan, he gets an annual pension of 50% of his final salary. While in case of DC plan, he contributes 10% of his salary and yet is entitled to receive annual pension of only 26.45% of his final salary.

Problems of Old Age Provision



Unorganized Sector

PRESENT STATUS

- No Social Security Scheme

- National Old Age Pension Scheme in terms of which central assistance is made available to the States and Union Territories subject to the following conditions:
  - Age of the applicant is 65 years or more
  - The applicant is a destitute in the sense as having little or no regular means of subsistence from his/her own sources of income or through financial support from family members or other sources
  - The amount of old age pension is at least Rs. 75 per month

- Old Age Pension for the purpose of central assistance has been enhanced to Rs. 200 per month w.e.f 1.4.2006 with corresponding matching contribution from States and Union Territories.

Result:

No. of States and U.T	Pension provision per month
17	greater than or equal Rs.400
11	greater than Rs. 200 but less than Rs. 400
7	Rs. 200

- Means Test has been modified to read as households Below Poverty Line.
- Efficacy of such a means-tested scheme is always questionable and figures of coverage will be known only after evaluation (in progress) is completed.
- Other Schemes - National Family Benefit Scheme and National Benefit Scheme - in the nature of poverty alleviation programmes and with question mark on ‘delivery mechanism’.
- Otherwise self-employed persons in the organized sector have to make their own provision for Old Age and this can be done through various schemes recognized u/s 80c, 80cc and 80ccc of the Income Tax Act, 1961, provided aggregate amount of contribution is allowed as deduction from Gross Income is restricted to Rs. 100,000/-

Some of these schemes are briefly described in the next slide

Subject to an overall limit of Rs. 1,00,000:

Scheme	Tax Treatment*	Maximum Limit
Public Provident Fund	EEE	Rs. 70,000 p.a
Life Insurance Premium	EEE	Premium should not exceed 20% of sum assured
Deferred Annuity	EET	No commutation allowed
Equity Linked Savings Scheme (ELSS)	EEE	Lock in period of 3 years.
National Savings Certificate	ETT	Interest is taxable but annual interest earned is deemed to be reinvested and qualifies for tax rebate for first 5 years under section 80 C of Income Tax Act
Unit Linked Insurance Plan	EEE	Lock in period of 5 years

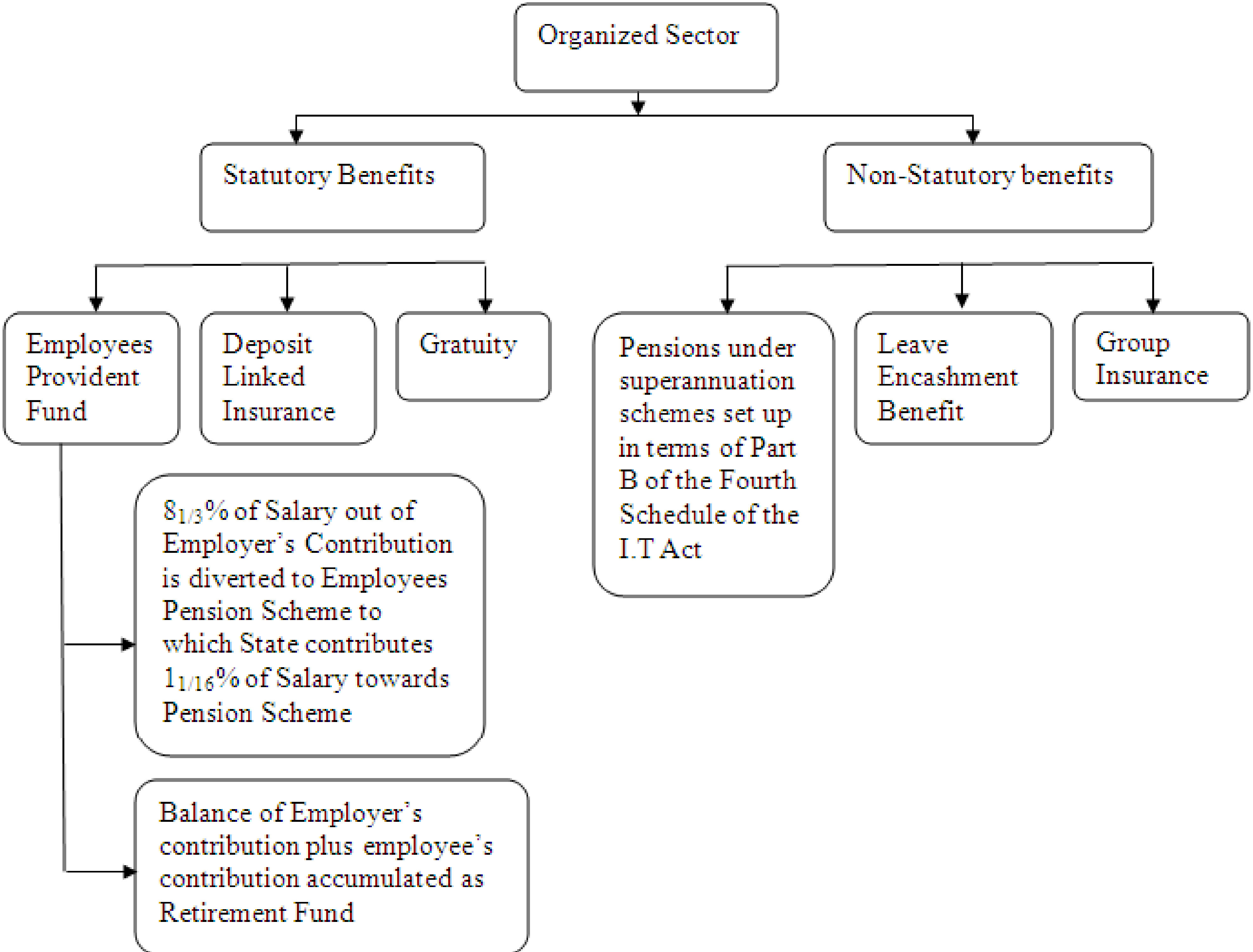
- * E = Exempt
  T = Tax

Contribution	Interest	Benefits	Tax Status
E	E	E	EEE
E	E	T	EET

Other investment areas for deduction under 80C

- Payments for notified annuity plan of LIC
- Any sum paid as subscription to any scheme of Public Sector Company engaged in providing long term finance for purchase/construction of residential houses or from the housing board in India engaged in planning and development of cities.
- Payment towards the cost of construction/purchase of residential property including payment of loan taken from Government bank, cooperative bank, LIC, National Housing Bank
- Approved debentures of, and equity shares in, a public company engaged in infrastructure including power sector or units of mutual fund utilized for infrastructure
- Amount in fixed deposits of 5-years or more with a scheduled bank in accordance with a scheme framed and notified by the Central Government
- Notified bonds from NABARD
- 5 year time deposit of Post Office
- Deposit in an account under the Senior Citizen Saving Scheme Rules, 2004

Organized Sector


Organized Sector
Statutory Benefits
Non-Statutory benefits
Employees Provident Fund
Deposit Linked Insurance
Gratuity
Pensions under superannuation schemes set up in terms of Part B of the Fourth Schedule of the I.T Act
Leave Encashment Benefit
Group Insurance
8 1/3% of Salary out of Employer's Contribution is diverted to Employees Pension Scheme to which State contributes 1 1/16% of Salary towards Pension Scheme
Balance of Employer's contribution plus employee's contribution accumulated as Retirement Fund

Contribution towards Post-retirement benefits

1.	Employers contribute 12% of salary towards PF	12%
2.	Employer provides gratuity of 15 days of final salary for each year of service	4.25%
3.	Employee contribute 12% of salary towards PF	12%
4.	Contribution to employees Deposit linked Insurance	0.5%
	Total	28.75%

SUMMARY

- All citizens be covered as on matter of right under Social Security Scheme(Pillar I).
- Tax/GDP ratio should be improved through better tax administration, plugging of loop-holes and removal of exemptions.
- Better compliance with Fiscal Responsibility and Budget Management Act under which fiscal deficit should not exceed 3%.
- Organized sector should be covered by an umbrella scheme providing gamut of benefits and fund can be either privately administered scheme or insured scheme.
- Private funds should be given the option to pay out annuities from the fund instead of compulsorily purchasing the annuities from the insurer.
- Private saving schemes should be encouraged by means of tax incentives based on EEE pattern (pillar III).
- Over all employed sector is well provided and what is needed is rationalization and consolidation.
- Present pattern of benefits – a jig-saw puzzle – needs to be reorganized under one umbrella scheme providing entire gamut of benefits- Old Age pensions linked to cost of living index, partial commutation of pension, widows pension, limited life insurance cover, disability pensions.

ANY QUESTIONS?

THANK YOU