“Pension Regulations in India”

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Introduction

Indian insurance industry is a sunrise industry and before the end of the day there is a long way to go. Insurance industry today is clearly a growth industry in India. Population of India is around 1090 millions in 2004-2005 with an average life expectancy at birth of male is 64years and 67 years for females. The number of elderly person is expected to increase to 113 millions. Thus Pension fund, act as a powerful engine for growth and go a long way in strengthening capital markets as they provide large amount of long term funds.

In India Old Age seems to be most unanticipated. Therefore, groundwork for it is quite inadequate. In India the joint family system has traditionally provided security to the elders and, being an agricultural economy, in India retirement was a gradual process, Therefore the need for social security provision for the old people, e.g. Pension products, were not felt necessary. Another reason for pension not picking up in India is inadequate disposable income. It is a worldwide experience that people with inadequate disposable income are reluctant to make long term financial commitments, because of this 42.5% of the financial household saving are in bank deposits which provide liquidity. However, with increasing urbanization and with the process of breaking up of the joint family system gathering strength and also with the increase in the disposable income of the common people the need to provide for social security to the old age are being increasingly felt and so also the demand for pension products increasing.

The main rationale for pensions is to protect against old-age economic insecurity. With increasing life expectancies, people want and need old-age insurance, which will protect them against the risk of outliving their total lifetime compensation. Lifetimes are uncertain, so people want to insure against the uncertainty. Thus, the central mission of a pension system is to assure the maximum extent possible for an adequate standard of living for people in old age. A system designed with this standard in mind would provide a larger benefit contributed for lower-income groups. The older generation has to seek support of the measures for securing a trouble free retired life. Despite, many Government schemes to provide the economic security to the aged and elderly persons, there is a need of introducing measures against the economic distress. On the other hand while people want insurance against longevity it’s difficult for providers to provide the insurance against the same. Therefore within the next few years arrangements for sharing of longevity risk between the provider and the pensioner would be the order of the day. Following these reasons pension reforms issues are being addressed.

Labor Force and Demographic Indicators

	Indicator	Time period	
1.	Life expectancy at Birth(Years)	2000-2005	
	Male		63.2
	Female		64.6
2.	Life expectancy at 60 (Years)	2001	
	Male		15.7
	Female		17.1
3.	Population(million)	2001	1028
	Male		532
	Female		496
	Sex Ratio		933
4	Population above 65(million)	2000	46.6
		2030	129.3
	Old age dependency Ratio (%)*	2001	11.9
5	Total Work force (million)	2001	424.6
	Urban Work Force(million)		97.6
	Rural Work Force (million)		326.9
6.	Working Age Population(million)		
		2000	619.7
		2025	921.5
		2050	1048.5

*Old age dependency Ratio (%) = Population above 60years/population15-59 years*100

Source: Adapted from Mukul Asher (2006) page 5, table2

	Population (In Millions)		% of Population Over 65		Population over 65 (Numbers in million)	
	2000	**2030**	**2000**	**2030**	**2000**	**2030**
China	1262	1483	7.0	16.0	88	237
India	1014	1437	4.6	9.0	47	129
USA	276	351	12.6	20.0	35	70
Vietnam	76	N.A.	5.8	N.A.	4.4b	N.A.
Indonesia	225	313	4.5	10.9	10	34
Brazil	173	203	5.3	13.2	9	27
Russia	146	133	12.6	20.5	18	27
Japan	127	117	17.0	28.3	22	33
France	59	62	16.0	24.0	9	15
UK	60	61	15.7	23.5	9	14
S.Korea	47	54	7.0	19.5	3	11
Malaysia	22	35	4.1	9.4	1	3
Australia	19	23	12.4	21.1	2	5
Singapore	4	9	6.8	14.8	0	1

Source: UNDP

The Indian pensions industry is currently divided into four major components, which are not integrated.

First, the Employees Provident Fund Organization (EPFO), which is under the Ministry of Labor, is the primary organization for retirement income for private sector employees. It administers a mandatory savings DC scheme (Employees Provident Fund Scheme or EPF Scheme) and a DB pensions scheme (Employees Pension Scheme or EPS), with survivor's benefits. The EPF has 26 million members, while the EPS has 23 million members. The combined assets of the EPFO schemes are about 7% of GDP. The EPFO is empowered to decide on the companies that may be permitted to administer their own provident and pension schemes and supervises the exempted firms, and essentially regulates itself through its own Board of Trustees.

The *second* component of the pensions industry consists of various occupational schemes; prominent among them are the schemes of public sector financial organizations such as banks, insurance companies, and the state owned enterprises. These are currently stand-alone schemes, which need to be integrated into the pension system as a whole.

The *third* component of the current pension system concerns the civil servants at the Center and in the States. Their retirement benefits include a non-contributory DB pension, with survivors' benefits, mandatory provident fund savings scheme of the DC type, and a gratuity. These schemes have their own structures, and there are no regulations concerning their design, financial viability, and investment patterns

The *fourth* component consists of tax advantaged voluntary saving schemes most of which are administered by India's Post Office Savings Bank (POSB). The POSB is the largest financial institution in the country, controlling deposits equivalent to 9% of GDP, larger than the assets of the EPFO.

Need for reforms in Indian Pension System

Economic security during old age should necessarily result from sustained preparation through life-long contributions" and that "the government should step in only in case of those who do not have sufficient incomes to save for old age".

Till now in India most of the people are out of the scope of Pension system. With the increasing life-expectancy and less informal support, lives of aged people are being difficult. Pension fund is related to infrastructure development also, so pension fund reforms were supposed to improve the quality of life of aged people. Along with this the rising burden of unfunded Govt. pension in India and retirement income for salaried workers in the unorganized sector has led the Govt. towards reforms

The aim of the pension reform initiative was to:

- Reduce the unfunded pension liability.
- Reduce the role of the state as pension provider.
- Increase the pension coverage and strengthening the means tested tax-financed pension for those who do not have adequate income to self-finance their old-age income.
- Reduce the disparity between sections of working population.
- Better value for money and service to the subscribers.
- Release of resources for means tested and tax financed assistance for those who cannot save for their old age.

Three reports have examined old age financial security for Indians and are now being studied for implementation by the government. These reports are:

1. Project **OASIS Committee Report**, December 29, 1999 (henceforth referred to as the OASIS Report)

2. Pensions Reforms in the Unorganized Sector – a report prepared by the **Insurance Regulatory and Development Authority, October 2001 (henceforth, referred to as the IRDA Report)**

3. Report of the High Level Expert Group on New Pensions System, Government of India, February 2002 (Henceforth referred to as **the Bhattacharya Report** named after its chairman)

Now, the suggestions regarding the pension reforms as given by **OASIS** Committee are:

- Individual retirement accounts, IRA to be created.
- Voluntary contributions into this account throughout work life for which distribution channels will play an important role.
- Accounting to be safe and proper as contributions is to be in small amounts.
- Operations to be cost effective.
- Points-of-Presence or POPs - to ensure easy access. Post Offices and bank branches to have POPs to start with. All transactions of IRA to be done through these POPs anywhere in India.
- Individual accounts to have full portability - IRA can be carried across job changes and different locations.
- Record keeping to be centralized and to have a central depository. Six pension fund managers to be recommended, who may bid for five years.
- Central depository to transfer blocks of funds to pension fund managers.
- Individuals could change funds managers if they are not satisfied with their performance.
- For premature withdrawals from the fund, disincentives have been recommended.
- Awareness programs through non-government organizations (NGOs) and other welfare associations have to be in place to establish the targeted market which would in turn include literate and semi-literate segment of the population.
- The pension fund manager to offer schemes of three styles - safe income, balanced income and growth.
- Favorable tax treatment for contributions, funds and annuity payments.
- The Pension Authority to regulate pension markets.

Bhattacharya Committee Recommendation for Government Employees

1. An unfunded defined benefit, pay-as-you-go scheme (PAYG), or a pure defined contribution scheme is not

suitable for government employees; instead a hybrid defined benefit/defined contribution scheme is recommended. This is a two-tier scheme. In the first tier, there is a mandatory contribution of 10 per cent each by employer and employee. The accumulated funds would be used to pay pension in annuity form. The second tier is to promote personal savings and there is no limit for employee's contribution but employer's contribution would be matching and limited to 5 per cent. Accumulated funds can be withdrawn in lump sum or converted into annuity at the time of retirement. These payments would be tax exempt and portable if an employee changes job before retirement.

2. Funds collected in the first tier would be deposited in a separate fund and would be invested in both debt and equity. Some funds can be earmarked for active fund management including for short term trading for better returns. However, irrespective of fund performance, government would remain liable for pension to its employees based on predetermined benefit formula.

3. Contribution obtained in the second tier will have a separate institutional structure and the employee would have a choice of funds (income, balanced, and growth) to invest in. Employees may decide to continue, quit, or swap among funds while in service. Government will not guarantee any specific rate of return.

4. The new schemes would be applicable to new employees only

IRDA Committee Recommendations for Non-Governmental Sector

The IRDA Committee's recommendations for reforms in the non-governmental sector are largely based on the OASIS report. The recommendations are as follows:

- Establish a system based on privately managed, individual funded defined-contribution accounts. Lump sum payments and/or annuity on retirement would be actuarially determined based on funds available.
- Privatize assets management functions of EPFO and exempt funds and allow private insurance firms to provide annuities. Increase coverage by covering more firms and by eliminating the present salary ceiling of Rs. 6500. Phase out the government subsidy of 1.16 per cent.
- For persons not covered by any scheme, allow a limited number of private asset managers to operate, each offering three investment portfolio options. Participants would have choice among fund managers selected through a competitive bidding process by regulatory authorities.
- Employers' and fund managers' responsibility to participants would be that of 'principal and agent' and

fiduciary in nature. Fund managers would work for a fee with no performance guarantee. However, it is hoped that with expert managerial skill and wider investment choice, participants would be better off than presently available through publicly managed funds.

- Government would need to provide tax subsidy to encourage acceptance of privately managed funds. The suggested tax measures are increasing entitlement of contributions towards pension for tax rebate up to Rs. 80,000; and providing for tax exemption on the income earned by pension funds, commuted value, and annuity amount received as pension. Existing deduction under Section 80 CCC of Rs.10, 000 should be withdrawn as it only defers the tax, since annuities received from these funds are taxable.
- Government should allow facilitated access to the system through its postal and banking network throughout the country to keep the administrative cost low.
- To supervise and regulate the system, an independent regulatory authority called the Indian Pensions Authority should be set up.

Year	Pension Payment (Rs. In Billions)	
	States	Central
1995-96	78.13	69.28
1996-97	98.27	82.52
1997-98	115.99	113.76
1998-99	161.66	153.46
1999-2000	226.79	194.46
2000-01	254.53	211.17
2001-02	281.96	218.26
2002-03	310.05	221.02
2003-04	352.79	236.29
2004-05	383.70(BE)	261.54(RE)
2005-06	N.A.	278.17(BE)
2006-07	N.A.	306.27(BE)

Source: PFRDA

BE: Budgeted estimate RE: Revised estimate

The reform in the Pension system and the adoption of a system based on fully funded Defined-Contribution is supposed to have advantageous effect on the Indian Economy. The effects are:

- The government's burden of administering pensions will certainly decrease.

- With the entry of private Pension fund managers, pension assets will be invested wisely thus providing a larger amount to individuals at the time of retirement.
- Pensions issue will be de-politicized and will become more of an economic issue.
- The development of the pension sector will create a symbiotic relationship with the Insurance sector.
- The element of forced saving inbuilt into the system of mandatory contributions will go a long way in increasing the rate of savings of the household sector which constitutes the largest part of savers in India. The effective mobilization of these will go a long way to aid capital formation and economic growth.

In specific terms, pension reforms must ensure that there is increased coverage for old age income, reduction in unfunded pension liability, reduction in the role of the government as a pension provider, better return and protection to the subscribers and higher availability of funds for means tested tax financed pension. Of the above 3 reports oasis report played integral part in the reforms of the pension sector in India.

But the real challenge in India lies in extending coverage of old age income security to the unorganized sector that includes agricultural workers, temporary and casual workers and self-employed persons. Considering the composition of labor force in the country, coverage cannot substantially be increased without including such categories. In that sense, India presents some unique problems, which need unique and innovative solutions in designing an institutional structure for old age income security.

The States need to establish institutional and legal structures covering as large a proportion of the population as possible. Thus enabling people to save a minimum amount for their old age and forcing habitual savings that would ensure that a person saves an amount at least adequate to meet his basic needs during old age so that he does not become a parasite on the society at large.

In order to ensure the proper implementation of the reforms, it is necessary to have a clear regulatory and supervisory frame-work. The regulatory framework prevailing in India is as follows:

<u>Current Indian Retirement Benefit System</u>

Pillar1	**Pillar2**	**Pillar3**
Pension system for Govt. employees	Pension for worker in Organized Sector (Non-Govt.)	Voluntary pension Scheme
Govt.-run defined Benefit Pension, Gratuity and Provident Fund	Mandatory defined contribution (EPF), Defined benefit (EPS) and Gratuity.	Product like Public Provident Fund and pension plan from insurance companies.
10.1mn employees	**29.8mn employees**	**2mn employees**

Current Pension Regulatory Frame-work in India

The current regulatory frame-work in India for pension's arrangements is outlined below:

- Pension for the government employees, who have joined service before 1stJanuary 2004, is not funded and is paid on "Pay As You Go" (PAYG) basis out of the current revenue. It is managed by the government.
- The complementary pension in the form of the proposed defined contribution fully funded individual account pension would require a regulatory frame-work for supervision which is proposed to be provided by the PFRDA.
- Public Provident Fund (PPF) is managed by the government with 75 per cent of the net accretions being given as loans to the states and balance credited to public account of the government.
- Employee Provident Fund (EPF) is administered and regulated /supervised by the Employee Provident Fund Organization (EPFO).
- Employee Pension Scheme (EPS) 95 is also administered and regulated/supervised by the EPFO. This scheme would also benefit from separating the regulatory and supervisory functions from the EPFO.
- Occupational pensions set up through approvals from the Commissioners of Income Tax (CIT) under the provisions of the Part B of the Fourth Schedule of the Income Tax Act, 1961 are envisaged to be supervised by the relevant CITs but this supervision remains confined only to ensuring adherence to the prescribed investment pattern.
- The gratuity funds set up through approvals from the CITs under Part C of the Fourth Schedule of the Income Tax Act, 1961 are envisaged to be supervised by the relevant CITs. and
- Personal pension products and group pension products offered by the life insurers are regulated and supervised by the IRDA and those offered by the MFs are regulated and supervised by the SEBI.

The prevailing scenario can be explained better through the tables mentioned below:

Table I

Present Scenario

Form of Benefit	**Who**	**Pays**	**What**	
1) Provident Fund*	Employer	Employee	State	Total
	12% of which8.33% is diverted to EPS=3.67 %	12 %	Nil	15.67 %
2) Employee Pension (EPS)*	8.33 %	Nil	1.16 %	9.5 %
3) Gratuity Scheme** providing Lump-sum equal to 15 days salary for each year of service subject to max. of Rs. 3,50,000	Actuarially determined cost	Nil	Nil	Actuarially determined cost

(1) & (2) at above refer to state scheme with a salary limit of Rs. 6,500/- per month. Private schemes can be set up either as exempted Funds or as Funds for employees not covered by the EPF Act in terms of Income Tax Act, 1961 as under : -

Present Scenario (Continued)

Tax Treatment

Nature of Fund	IT Reference	Limit on Contribution	Employer	Employee	Benefit	Interest
Recognized provident Fund	Part A of the Fourth schedule	Maximum is 12 %	Allowed in full	Only deduction equal to 20 %	Tax-free	Tax-free
Approved Superannuation fund	Part B of the Fourth schedule	27% less contribution to PF	Allowed in full	Only deduction equal to 20 %	Commuted value Tax-free Pension Taxable	Tax-free
Approved Gratuity fund	Part C of the fourth Schedule	Actuarially determined cost	Allowed in full	N A	Tax-free upto limits of payment of gratuity Act 1972	Tax-free

As can be seen, the regulation and supervision of pensions is fragmented and this needs total review. With the various initiatives on pension reforms being on the anvil, the Govt. has announced in the Budget 2003-04, a new pension system based on Defined Contribution, shared equally in the case of Govt. employees between the Govt. and the employees. Under the scheme there will be no contribution from the Government in respect of individuals who are not Government employees. It was announced that the new pension scheme will be portable, allowing transfer of the benefits in case of change of employment, and will go into ‘individual pension accounts’ with Pension Funds. The new pension system was made operational through a notification dated 22nd December 2003 applicable only to new recruits in the central government from 1st January 2004. An interim Pension Fund Regulatory and Development Authority (PFRDA) was also set up through a Resolution of the Government dated 10th October 2003 and the Authority started functioning from 1st January 2004, and would regulate and supervise the pension business.

Principles of New Pension System (NPS):

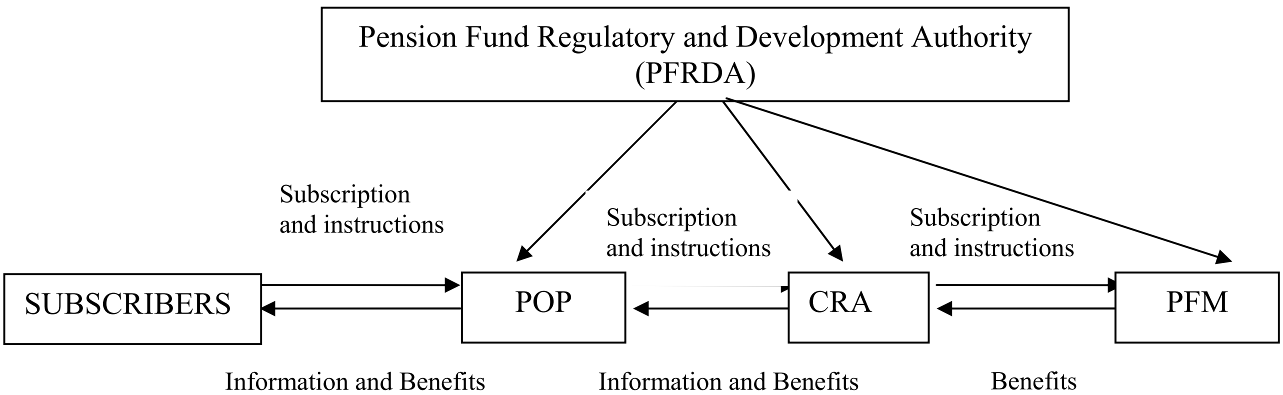
- Defining upfront liability of Government on pension payment.
- Giving choice to subscribers.
- Facilitating portability of labour force.
- To ensure transparency and fair-play in the industry.
- To build a model this is capable of handling large numbers in unorganized sector.

The following are the details in respect of the New Pension Scheme (NPS) as currently being implemented under the executive set-up:

- NPS would be available for the central government employees appointed on or after 1st January 2004 except those in the armed forces on a mandatory basis. The scheme shall be made available to all individuals in the unorganized sector on voluntary basis. All participants will have individual pension account which would be portable.
- An amount equivalent to 10% of the basic salary has to be contributed towards the pension by the central Government employee and a matching amount is to be contributed by the employer i.e. Government of India.
- It is proposed that at the time of retirement there will be compulsory annuitisation of the 40% of the accumulated pension wealth so as to achieve a reasonable pension. The balance 60% will be paid as a lump sum, which he would be free to utilize in any manner.
- The contribution and accumulation are exempted from tax up to a limit, but benefits will be taxed as normal income.
- The existing scheme of pension, GPF and Gratuity would cease for new entrants of the Central civil services .In order to promote savings for expenditure during service time there will be a second tier to the new pension scheme which would be a voluntary scheme with no contribution from Government.

The second tier shall be operationalised once the full architecture of the NPS is ready. However, no Government contribution shall be made in the second tier. The employee would be free to withdraw her Tier II money anytime. This withdraw able account will not constitute pension investment, and would attract no special tax preference.

- As with civil servants, individuals in the unorganized sector can ask for investment protection guarantees on investments under various pension schemes offered by Pension Funds. However, this guarantee would be implemented using normal financial markets instruments.
- The Bill does not cover any scheme or funds under the Coal Mines Provident Fund and Miscellaneous Provisions Act 1948, the Employees' Provident Funds and Miscellaneous Provisions Act 1952, the Seamen's Provident Fund Act 1966, the Assam Tea Plantations Provident Fund and Pension Fund Scheme Act 1955, and the Jammu and Kashmir Employees' Provident Funds Act 1961, or contracts covered by the Insurance Act 1938. It also exempts employees of central government and All-India Services appointed before January 1, 2004. Any person governed by any of these exempt schemes may voluntarily choose to join NPS in addition to their mandatory cover.
- There would be an independent Pension Fund Regulatory and Development Authority (PFRDA) to regulate, monitor and supervise the new pension scheme.
- Government would not be required to create any additional infrastructure for collection, accounting, record-keeping etc. Existing infrastructure of banks, depositories etc. can be used for collection, accounting record keeping etc.
- There will be multiple pension fund managers licensed by PFRDA and the choice would be with the individual employee to decide which fund manager he/she would like to go with.



The NPS Architecture

Comparison of Current System with NPS

	CURRENT SYSTEM	NPS
Coverage	Organized sector employees through EPS and govt. employees	Available to all subscribers, including the unorganized sector
Eligibility requirements	Minimum term of Employment(typically 10-15 years)	None
Type of Pension	Defined Benefit	Defined Contribution
Type of Account	Pooled	Individual pension Account(IPA)
Risks	The employee carries no risk .however he is faced with the risk of default or delay in pension payment by the govt. or EPS	The employee carries the entire investment risk
Disclosure of performance	None.	Each PFM will publish the performance of scheme managed by him at regular intervals. The subscriber can see the balance in his IPA
For Govt. Employees	For existing central Govt. employees, the govt. pays 50% of the average of the last 10 month pay(Basic +D.A.) if employee has 33 years service. There is no contribution by the employee.	Govt. and the employee will each pay 10% of basic +D.A. into the scheme of a PFM. Separate Account for each employee will be maintained. At the time of exit ,a part(now 40%)of the pension wealth will be used to buy a annuity and the remaining paid as the lump sum amount
For those not employed by the Govt.	For those covered by EPS, the employer pays 8.33% of basic + D.A. to the EPS (maintained by EPFO) and the Govt. pays 1.16%. EPS will pay pension after retirement at the rate based on the years of service and last pay drawn.	No contribution from the employer. The employee select a particular scheme
Investment strategy	The EPS board decides the strategy and investment portfolio ,which is not disclosed to the employees	Each scheme has to follow a specified investment pattern which the subscriber chooses.

Source: PRS

Why ***PFRDA*** bill?

The main Objectives of its formation are:

- *To protect the interests of workers:*

A subscriber joining at age 25 will stay in the new pension system for about 35 years till retirement and 20 years thereafter. The PFRDA is envisaged to regulate and supervise the contribution and accumulation phases and IRDA is envisaged to regulate and supervise the pay out phase.

- *To sustain member confidence:*

A statutory regulatory body with penal powers is essential to sustain member confidence and to protect the interests of participants.

- *To increase public confidence:*

Increasing public confidence in the new system with a focused regulator is necessary which is adequately empowered through a legislative backing.

- *For the development of pension sector:*

Developing the pension sector by inculcating saving habits for long term in order to smoothen the consumption of citizens require a robust architecture under a statutory regulator.

- *Setting basic rights and obligations:*

The regulations should set out the basic rights and obligations of the relevant parties - the pension scheme members, the trustees, the employer, and the service provider.

- *Achieving secure framework*:

The integrated package of legislation along with self regulation through the actuaries, auditors and other professionals should help in achieving a fairer and more secure framework for pension system.

The PFRDA would have to be established through an Act of Parliament. However, initially, an interim PFRDA has been set up through an executive order. The interim PFRDA has drafted the Bill for establishment of the statutory authority and would frame the regulations that would be required for regulations and supervision of the NPS.

Role of PFRDA:

- The PFRDA would license and regulate / supervise the Pension Fund Managers under the proposed DC pension and cover 'other pensions' when entrusted.
- The regulatory body should ensure that security of pensions is not put to risk and that management systems are sound.
- Regulation and supervision should not be through imposition of minutely detailed regulations.
- A broad framework be so laid down that the objective is achieved through self regulation and minimum regulation through legislative processes.

For making people understand the NPS and the risks associated with a defined contribution pension in proper perspective the actuaries will play an important role. They need to give sophisticated actuarial calculations and data-base, with requisite professional expertise and, in enabling people to achieve the targeted pension in Defined Contribution pension environment. The role of actuaries in the Defined Contribution pension environment could be outlined as follows:

1. DB to DC conversion process;
2. DC projections;
3. DC investments;
4. Analyzing the range of options;

Drivers for switching from Defined Benefit to Defined Contribution

For Employer:

- More predictable annual employer cost.
- Have no open ended long term liabilities
- No obligation to pay default insurance premium
- Lower cost of administrating a plan

For Employees:

- Profitability
- Offer flexible payout option
- Assets to be transferred to the survivor
- Allow employee more involvement and control over their saving

Government finances

The NPS is mandatory for government employees appointed since January 1, 2004. Most of these employees will retire about 30-35 years from now. During this period, the government will continue to pay pension to retiring employees under the old regime as a DB plan. The government will also contribute 10% of the Basic+DA of new government employees to the DC plan. Thus, the actual costs to the government will rise. This will reverse as the proportion of new employees among pensioners rises.

Gains under new system will occur from year 2038-39. Computations presented to the Standing Committee suggest that the incremental cost to the government will peak at Rs 2,900 crore in 2021-22, and then decline. Savings will be apparent after 2038-39, and will rise from Rs 1,000 crore in 2039-40 to Rs 37,000 crore in 2059-60 and Rs 72,000 crore in 2081-82. However, these estimates must be viewed with caution as they make several simplifying assumptions owing to lack of detailed data. These include assumptions about age profile of existing pensioners and serving employees, downsizing central government employment, gender profiles etc. [Source: 21st Report of Standing Committee on Finance on PFRDA Bill 2005, which quotes the High Level Expert Group (Chairman: BK Bhattacharya)].

Growth projected after the **Post Reform** scenario:

Contributions(in Rs.Bn)	2010	2015	2020	2025
Funded Schemes				
EPS EPF	461	696	1023	1498
Of which Voluntary	8.5%	9.3%	10.1%	11.0%
Of Total Contribution	39	64	103	164
GPF	133	201	295	431
PPF	84	127	186	272
Individual Pension	183	306	513	756
Group pension	708	824	968	1108
Total Contribution	1569	2154	2986	4064

Risks under NPS system

Under the NPS, PFMs will offer an array of schemes (the current notification specifies 3 types) offering differing risk-return profiles with that at least one scheme fully invested in government securities as recommended by the Standing Committee. The subscriber divides his contribution (as well as existing pension wealth) into these schemes, and has the option of changing this combination at any time. The final pension wealth will depend on the performance of the schemes chosen by the subscriber, which means that the subscriber takes the entire investment risk

The subscriber is exposed to two major risks at the time of exit i.e. if there is a major market shock at the time of retirement (say, an incident such as the attack on Parliament on December 13, 2001), leading to a fall in asset prices, the entire accumulated wealth is at risk. A subscriber with a few years to exit would likely ride over this shock but a subscriber retiring at that time will be affected adversely. Secondly, the subscriber has to purchase an annuity at the time of exit, and is similarly exposed to any sharp downturn in the annuity market at that time.

The Bill states that there will not be any explicit or implicit assurance of benefits except market based guarantees to be purchased by the subscriber.

Major Challenge Ahead:

Introduction of New Pension System for new recruits of Central government/ state government is a positive step in direction of reforming the pension sector in India. The road ahead has many challenges which need to be tackled effectively for the system to spread wide enough.

Some of the challenges are:

Awareness:

- Creating awareness and educating people about building up assets for old age income.
- With Govt. initiatives, creating awareness regarding pension from the very ground level, i.e., from the school level itself.

Implementation

- Designing an effective, efficient and assessable system which caters the requirement of a heterogeneous workforce which is nearly 88% which is not covered under pension or old security scheme is the challenge in hand.

- Reduction of the Management cost, is a major issue that needs to be taken care. Presently as recommended by Oasis committee it is around .25% of the assets under management. The typical mutual fund recurring costs are 2.5 % for an equity fund, 2 % for a balanced fund and 1.5% for a debt fund and in this context the cost estimate of 0.25 % appears very ambitious. The easiest way out is that, if the government employee's pensions and exempted provident funds are unified with the proposed pension schemes it would help in managing the proposed pension fund costs.

Rural Penetration

- Taking the help of NGOs to penetrate the rural market through various awareness programs, educating the women mass and the youth as they are not only the source of information but also play an equally important role in decision making.
- Developing schemes for rural sectors where it takes minimum and gives them an amount to sustain certain standard of living.

Role of Government:

- The problem of financing of pension liability in New pension set up is a big challenge and some changes have to be made for effective and efficient discharge of this liability.
- Provision for Along with Pillar-II and Pillar-III models the Govt. also needs to address the old age income provision for those below the poverty line.
- Reduce the "Policy Risk" and provide reasonable retirement income to the policy holders.

Marketing & Distribution:

- Motivating agents and the intermediaries for selling pension products by providing proper training and good incentives to them.
- Customization of products from the company's side.
- Ensure easy availability by all sections of the society, through a vast number of POP (Point of Presence).

Conclusion

The pension reforms issue is highly complex and it would take time before it will be able to solve and provide solutions to the various aspects involved.

Most countries seem to seek to evolve the pension reforms around the World Bank solution and have multi-pillar pension system, with social security as the first pillar, a funded second pillar based on the individual retirement accounts system and the third pillar based on individual initiative.

In India the new pension system is in the process of evolution and the problems like ageing population, changing social structure, fragmented coverage, pressure on government finances, debt oriented investment pattern for retirement benefit schemes and general economic conditions are needed to be solved by it. The recent initiatives on the part of the government to set up a committee for devising pension system for India and change over to defined contribution pension scheme for the government employees joining service from 1st October 2001 are indicative of that need.

While the efforts to strengthen Pillar II and Pillar III are on, the Government will have to address the issue of old age income to those below the poverty line as this section of the population does not have the ability to make any provision for their old age and if this measure is taken seriously and implemented it would help the to provide old age income to people who most needed it.

Though the process is slow and will take time. Nevertheless it’s not impossible with right approach and attitude, we do believe in the old adage “Slow and steady wins the race”.

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