Institute of Actuaries of India

FINANCEwizards

Imparting Financial Skills

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Evolving Frontiers, Exciting Prospects

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Pension Fund Industry in India – Scope for the Future

Social Security in India

As per universal declaration of Human rights Social security is a concept which states that everyone, as a member of society, has the right to social security and is entitled to realization, through national effort and international co-operation and in accordance with the organization and resources of each state, of the economic social and cultural rights indispensable for his dignity and the free development of his personality

Indian Context- Issues

- Average Life Expectancy is on a rise
- Trend is moving away from traditional joint family system
- Inflationary pressures are high and one needs to be provided for the non earning periods in life
- There are a large number of people working in the unorganised sector and are self employed who do not have any access to any form of retirement benefits.
- Even in the organised sector governments and corporations find it difficult to sustain with defined benefits
- Less than 12 percent of the work force is in organized sector

Workforce in India

- Workers in Organized Sector- Working in the establishments covered by shops and establishment acts of state or Factories Act,1948, Industrial Establishment order, 1946
- Workers in the organized sector have some access to retirement benefits as per the legislations
- Workers in unorganized sector face the following

  a. Lack of Labor Laws

  b. Temporary nature of employment

  c. Seasonality in Occupation

  d. Presence in both urban and Rural areas including remote areas
- Disproportionate increase in number of workers in unorganized sector

Year	Total Workforce	Organized Sector	Unorganized Sector
1991	314 Million	27 million	287 million
1999-2000	397	28 million	369 million

Pension Reforms in India

- Countries and economies across the world migrating from defined benefit system to defined contribution system
- DC Assets growing at a faster rate than the DB assets in 13 selected economies
- Pension assets comparable to GDP as proportion in major markets across the world

Indian Context

- Lack of Social Security Framework
- Fiscal Stress due to defined benefits
- Oasis Committee
- Pension Fund Regulatory and Development Authority
- New/National Pension System
- PFRDA Bill/Act

National Pension System

- Introduced in 2004 for new Entrants in Civil Services
- Based on Chilean Model- Defined Contribution
- Opened for general public since 1st of May 2009
- Framework- Pension Fund Managers, Central Recordkeeping Agency, Multiple and geographically well distributed points of Presence
- Features
  - Self Sustainability
  - Scalability
  - Individual Choice
  - Maximising Outreach
  - Low Cost
  - Efficient
  - Regulated
- Adopted by 27 state governments for their new employees
- Department of Posts has also been included as point of presence to ensure reach to all the remote areas
- NPS Lite for Weaker Strata of Society

National Pension System

NPS Swavlamban Scheme

- Launched to promote NPS for the workers of unorganized sector
- Government contribution of INR 1000 every year to the accounts opened in 2010-11
- Initially announced for three years, has been extended for five years for subscribers enrolled in 2010-11,2011-12,2012-13
- Focused, Simple, Safe, Economical, Portable

Status of NPS* (Feb 2013)

S.No	Employer/Sector	Number of Subscribers	Corpus Under NPS(In Rs. Crores)
1	Central Government	11,15,457	16,763
2	State Government	15,48,778	9,269
3	Private Sector	1,95,869	1,196
4	NPS Lite	15,05,261	396
	Total	43,65,365	27,624

*Source : Ministry of Finance , Government of India

Global Scenario

1	Australia	There is no requirement to take annuity, but those who chose to convert into drawdown products tax benefits are available.
2	Canada	In most circumstances, the benefit from a registered DC Plan must be transferred to a locked-in retirement account, a Life Income Fund (LIF) or an annuity. There are minimum and maximum withdrawal amounts from the LIF, which take into consideration the member's balance and age. There is no requirement for Registered Retirement Savings Plans but for those who convert their benefit into a tax-advantaged Registered Retirement Income Fund, there is a minimum withdrawal percentage based on age.
3	Chile	All benefits must be converted into a life annuity or a programmed withdrawal product, except for any portion of the benefit that is above the specified maximum.
4	Denmark	The tax rules provide no limit on the contributions paid into a DC plan if the benefit is taken as an annuity. However there is a limit on the contributions if the benefit is paid out as instalments for a period of between10 and 25 years. Contributions for other forms of benefits cannot be claimed as a tax deduction.
5	Netherlands	All retirement benefits must be converted into an annuity. Annuity payments are fixed but may be increased if profit sharing results allow for it. Several annuity options are available at retirement.

Global Scenario

		retirement.
6	Singapore	The retirement benefit is converted into a life annuity, if it is above a prescribed minimum. Amounts above the prescribed maximum do not need to be converted.
7	Sweden	All retirement benefits from a DC plan must be converted into an annuity which could be a life annuity or a fixed term annuity, depending on the options available from the insurance company. However the individual bears some risks as the insurance company can vary its assumptions and payments, even after the payments have commenced. Some policies guarantee a return of premiums.
8	India	
9	UK	In most circumstances, 75% of the accumulated retirement benefit must be converted into an annuity or an income drawdown product, where a maximum drawdown is permitted each year. A more flexible drawdown is available for those with income streams above a prescribed level.
10	USA	There are no requirements for DC plans (such as 401(k) plans) to provide annuities or income stream products.

Indian Scenario

Following Acts cover various Social Security Schemes available to employees in the organised sector in India

- Employee State Insurance Act, 1948
- Employee Provident Fund and Miscellaneous Provisions act, 1952
- Employees Compensation Act, 1923
- Maternity Benefit Act, 1962
- No Coverage for unorganized sector workers and Self Employed Professionals

Organizations

- Employee Provident Fund Organization (EPFO)
- Employee State Insurance Corporation

Public Provident Fund

- Defined Contribution option available for general public/retail investor
- Varying Return fixed from time to time
- Yearly Limit of INR 100000 on investment
- Taxation Status- Exempt at investment, Exempt at accrual, Exempt at maturity
- No compounding of interest within the year
- Attractive yield- 8.7% tax free , currently
- Maturity of 15 years can be increased in the blocks of 5 years.
- Total AUM under the Scheme still small as compared to EPF

The Changing Indian Demographics

- From 5% of Population in 1961, the share of elderly expected to increase to 12.4 % by 2026
- 180 Million above 60 people in India by 2030
- Remaining age at 60 – 18 years
- Remaining age at 70-12 years
- Longevity is increasing

The increased proportion of aged population means

- Increased Pension outlays
- Higher expenditure on healthcare
- Lack of measures of subsistence in non earning years
- Indian elderly poorer than their western counterparts , which accentuates the problem
- Mammoth size of population makes planning very challenging

The Way Forward

- India houses one eighth of the world's elderly- they need to be provided
- Indian Pension assets are expected to grow to 1 trillion by 2025
- Pension asset have long term investment profile, which makes the investment suitable for long term infrastructure projects leading to a sustainable development
- The rise of pension funds is expected to provide stability to our capital markets in form of creating domestic institutional investors thereby reducing our dependence of Foreign Institutional Investors.
- Insurance and Mutual Fund companies which have a very limited presence in the retirement industry have to play a very active role so that the retail investor has an option to plan for their own retirement
- India is on the cusp of growth with the ratification of PFRDA Bill in the parliament, there is a huge need for pension funds to set up shop and start offering the pension products today to the young working class who are not entitled to any defined benefit plans even if they are working in the organized sector
- The huge growth in the number of workers in the unorganized sector as compared to the organized sector calls for an all inclusive way like NPS which is expected to gather storm and become a force to reckon with in the financial markets.
- People who can afford to buy annuities need to be encouraged and provided options to do the same

Financial Planning Approach

Financial Planning is a goal based approach of managing one’s Finances and includes following areas/disciplines of personal finance

- Insurance Planning
- Investment Planning
- Retirement Planning
- Tax and Estate Planning
- The approach is diagnostic in nature and ensures that no area of personal finance is missed out when one is planning his /her finances preferably in consultation of financial advisers/ planners.

- Since Retirement is a full fledged area of financial planning, it is therefore ensured that an important goal like retirement which looks remote in time is not overlooked while planning for other short term financial goals which are not so crucial or certain

Conclusion

A thrust in this area coupled with right regulations will be the steps in the direction of creating a vibrant pension fund market which will employ finance professionals of the future and giving enough options for the earning individuals of today to save and invest for their retirement in such a manner that one is able to live a life free from financial worry

The process has begun with the passing of PFRDA Bill in the parliament and it is expected that this will take the pension industry in the right direction thus creating a conducive atmosphere for planning for a very important phase in life of every working individual "RETIREMENT

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THANK YOU