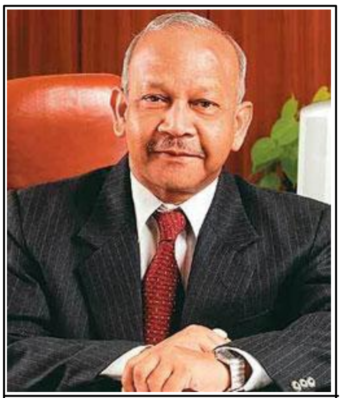
National Pension System-Old Age Security for Millions-Prospects and Challenges

"You can be young without money but you can't be old without it."

Tennessee Williams



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The UNFPA report, released recently, has once again pointed to the increasing graying population in India. The report projected a 326% increase in number of people aged between 60 and 80 by the year 2050 from 2000; a 700% increase in the number of people older than 80 and a 55% increase in the country's older population. The demographics of today also indicate an increasing longevity with a more active lifestyle post retirement owing to betterment in medical facilities. With the shift to nuclear families, intergenerational support cannot be the sole source of old age security. Statistics indicate that only about 12% of the total population is covered by organized old age social security schemes in India and workforce in the unorganized sector has limited access to formal channels of old age economic support. Hence creation of a viable old age security system has become an imperative to counter the fast dwindling demographic dividend.

However, the onus of funding the entire old age security cannot squarely lie with the government which is already reeling under the pressure of ever contracting budgetary resources. In fact, the current global demographic shift toward population ageing, largely reflecting rising life expectancy and declining fertility has led many countries across the world to re-evaluate their pension systems. Typically, they switch wholly or partially from unfunded systems, e.g. pay-as-you-go (PAYG) or defined benefit system to funded systems like defined contribution system. It is this switch which is responsible for the build-up of Pension Assets in the economies in last couple of decades. This pool of assets is being increasingly looked upon as one of the potential drivers of economic growth.

The National Pension System (NPS) launched by GOI and supervised by the Pension Fund Regulatory & Development Authority (PFRDA) has evolved out of this very need to provide old age security to the vast multitude of Indian population, without unduly straining the fiscal fabric of the Govt and simultaneously providing for the long term investment funds for the economy.

The NPS is a highly innovative and sophisticated product and is based on the world's best practices in the pension sector involving disciplined saving, vigilant investment to build a sufficient retirement corpus and its judicious draw down in the post retirement phase. It was initially launched for government and semi-government employees on 01.01.2004 to put a cap on the Govt's liability towards Civil Servants pension, unavoidable under the pay as you go system, marking a paradigm shift from defined-benefit to defined-contribution pension system.

As a result of implementation of NPS, all employees of the Central Government and of Central Government autonomous bodies, with the exception of the armed forces, are now covered by the NPS. Besides, 23 State Governments have also joined NPS and 3 State Governments have notified joining NPS in respect of their employees. As of now, over 2.9 million Government employees, from Central and State Governments, have already joined the NPS and the corpus of their contributions has crossed Rs 32,723 crores,

Subsequently NPS has also been made available to all citizens of India on voluntary basis w.e.f. 1st May, 2009. Any citizen of India between 18-60 years of age fulfilling minimum eligibility criteria can join the NPS. Subscribers are eligible for tax benefit and they can also choose the PFM, investment option from the given asset class. Till June 2013 NPS had a total of 51.30 lakh subscribers & managed around 34975cr.

The NPS is a well regulated and transparent scheme. It is portable across geographies and employments. It being technology driven, subscribers can view their accounts online. It has laid down prudent investing norms for the fund managers, and their performance and portfolios are regularly monitored by the NPS Trust under the overall supervision of the PFRDA. The scheme offers complete flexibility to investors in terms of choice of investment mix. The investor decides the percentage of the corpus that goes into equities, corporate bonds and government securities, with the only limitation being, there's a 50% cap on the exposure to equities.

One of the most outstanding features of the NPS is the "life cycle fund". It is meant for those who are not financially aware or inclined to manage their asset allocation themselves. It is also the default option for someone who has not indicated the desired allocation of his investments. Under the life cycle fund, the investor's age decides the equity exposure. The 50% allocation to equities is reduced every year by 2% after the investor turns 35 till it becomes 10%.

This is in keeping with the strategy to opt for higher-risk-higher-return portfolio mix earlier in life, when there is ample time to make up for any possible black swan event. Gradually, as the investor approaches retirement age, he moves to a more stable fixed-return-low-risk portfolio.

This automatic re-jigging of the asset allocation is a unique feature of the NPS. No other pension plan or asset allocation mutual fund offers such a facility to investors. There are a few asset allocation funds based on age but they are one-size-fits-all solutions, not customised to the individual's age.

NPS-Corporate model also provides a platform to the corporates to co-contribute for the employee's pension. It also offers flexibility in contributions (equal/unequal) by employer and employee as decided mutually by them subject to the minimum contributions as prescribed by the PFRDA. NPS Corporate model provides flexibility to select the investment scheme either at corporate level or at subscriber level The Corporate model enables the employer to outsource the administrative, recordkeeping & fund management functions to NPS at no additional burden. Besides, both employer and employee get a tax benefit.

A unique feature of the NPS is the tax benefit it offers under the newly added Section 80 CCD (2). Under this section, if an employer contributes 10% of the salary (basic salary plus dearness allowance) in the NPS account of the employee, this amount will get tax exemption without any upper limit. This exemption is over and above the Rs 1 lakh tax deduction under Section 80C. It's a win-win situation for both because the employer also gets tax benefit under Section 36 I (IV) A of the Income Tax Act for his contribution. By contributing to NPS, employer can provide an additional tax benefit to the employee by simply reorganising the salary structure without incurring any additional cost to the company (CTC)

However, NPS is yet to achieve Tax equivalency with other financial products like EPS, PPF etc which have EEE (Exempt –Exempt-Exempt) status as against the EET (Exempt- Exempt- tax) status for NPS. However, a level playing field expected with the forthcoming Direct Tax Code (DTC), will provide the necessary fillip to the growth of NPS in the organised sector.

The distribution mix of any product is generally dependent upon 4 C's- Cost, Control, Complexity and Customer outcome. As the rationale behind NPS has been achievement of universal old age income security, low cost besides outreach has always been the overriding factor in selecting the distribution channels. The NPS distribution mix at present consists of plethora of entities panning across the spectrum of public and private sector having a wide geographical spread across the country. The distribution of NPS is conducted using a host of existing financial infrastructure of public and private sector financial institutions like private and public sector banks, Regional Rural Banks, Micro-Finance Institutions, Non Banking Finance Companies, Non Government Organizations, welfare bodies etc to drive down operational costs.

This approach has helped in the organized sector, where employers –Central Govt, State Govt and Corporates conduited their employees to NPS. The unorganized sector, however, continues to be largely untapped. Lack of awareness and Complexity of the product has also influenced Customer outcome. As the awareness about NPS is low and investors seek financial consultancy before opting for NPS, since 2012, Pension Fund Managers (PFMs), who were earlier ring fenced to perform only fund management, have been directed to the stakeholders to distribute and market the product as well. The Pension Fund managers who are actually managing the investments and get a direct fee on the collected corpus, have a direct interest in marketing an NPS besides having know-how of the product.

As NPS is still a nascent product, the optimum mix of distribution and marketing channel is still under evolution, awareness and media campaigns shall have to play an important complementary role to provide effective thrust and push to NPS to provide wholesome and universal age old security coverage to the increasingly graying Indian population at affordable price.

Pension funds have an equally important role to play in the inclusive growth of the economy and henceindustry will have to come up with innovative strategies and distribution system to tap the 'Bottom of Pyramid'. In October 2010 GoI launched, a historic initiative to address the old age protection need of the unorganized sector workers. "Swavalamban Yojana" is a novel endeavour by GoI to support individuals in the unorganized sector in achieving old age security and dignity. GoI will contribute Rs 1000 per annum to all eligible NPS Swavalamban accounts where the subscriber deposits a minimum of Rs 1000/- to maximum Rs. 12000/- per annum. The incentive is presently available till 2016-17. As on Jun/30/2013, more than 2.0 million subscribers have been enrolled under the scheme with AUM of Rs. 624 crs.

When saving for a long-term goal such as retirement, the costs matter a lot. Over 35-40 years, the charges can shave off a significant amount from the corpus. The NPS charges fund management fees of 0.0102% for the government employees and there's a ceiling of 0.25% for the private sector. This is perhaps the lowest in the world. Account opening, handling and administrative charges are also the lowest, making the cost adjusted returns of NPS quite attractive in the long run. It has been estimated that the all in cost of NPS including the fund management fees, will not exceed 0.50 % per year, making it the cheapest financial product in the country. The returns of the NPS for all citizens have outperformed the market in the last one year ending as on 31.03.2013 as can be seen below:

Scheme	Average return by PFMs (%)
EQUITY (E)	8.39
Corporate Debt (C)	14.19
Govt Debt (G)	13.52

The NPS allows one to accumulate the corpus from the age of 18 years for forty odd years irrespective of geographies and employers in a single PRAN account. There is minimal leakage in the form of withdrawals for competing consumption expenses. This allows the investor to reap the compounding effect of tax concessions and low fees, invest the corpus as per one's risk appetite with professionally managed funds, generate optimum returns followed by a seamless transfer of retirement wealth from the accumulation phase to any of the seven IRDA regulated Annuity Service Providers (ASPs) of ones' choice on reaching 60 years of age.

Over and above this, the NPS offers the flexibility to draw upto 60% of the retirement corpus as lump sum to meet one's financial life goals like children's marriage or housing etc or draw down the lump sum corpus in one shot anytime till one is 70 years old. The rest can be utilized to purchase annuity of ones choice out of the bouquet of annuities offered by the ASPs.

CONCLUSION

Driven by the demographics, imperatives of rising fiscal deficit and investment needs of the economy to spur economic growth and to provide for old age security to the growing millions of graying population, National Pension System (NPS) was introduced, initially for the Govt employees in 2004 and subsequently opened to all citizens of the country in 2009 thereby leveraging the sophisticated, technology driven, innovative architecture already in place. Within a relatively short span of time, NPS has garnered a total of 51.30 lakh subscribers by 30.06.2013 & is managing around Rs 34,975 cr of funds.

Retirement planning through NPS involves disciplined saving, prudential investment by PFMs to build a sufficient retirement corpus and its judicious draw down in the post retirement phase. The platform offers a plethora of options starting right from the point of contact *viz* POP / aggregators, flexibility of frequency and contribution amount , the choice of PFMs, investment mix during investment phase, and finally choice of ASPs and a bouquet of annuities to the subscriber to optimise one's retirement wealth and replacement income as per one's economic situation in life. For the financially unaware subscriber at the other end of the spectrum, default options like life cycle fund, default PFM , default Annuity service providers and default annuity have been built in the system to nudge him to save for old age with confidence in a financially sophisticated product. In that respect, NPS is probably the only Govt backed broad spectrum, wholesome, universal, technology driven seamless retirement planning product in the country today, which in due course can achieve the objective of providing Universal pension coverage to the increasingly graying millions in India at affordable price , both in the organised and the unorganised sector.