

# Policy Choices for NPS Swavalamban

Workshop on Pension Policy in India NIPFP, February 24, 2015

### The enormity of the challenge ahead



<u>Informality of</u> <u>India's Workforce</u>	85% of India's 46 crore workforce is in the Unorganised sector Only 17% of elderly households receive some kind of Government benefit including NOAPS
<u>Household</u> <u>investments in non-</u> <u>financial Assets</u>	Gold, housing, livestock, land – not ideal as retirement savings
<u>High Inflation</u>	Inflation leads to loss in value of the corpus even when adequate growth is built in

### NPS- Swavalamban: Salient Scheme features



Current 28.36 lakh subscribers enrolled (0.8% of targeted beneficiaries)

### What must be envisaged as the scheme outcome?



# General Principles for Coverage

Pension must at a minimum, secure the post-retirement expenditure of an individual in the lowest income group

#### Approach to Analysis:

• Household expenditure data of 2.25 lakh remote rural Indian households obtained from an RFI used to obtain per capita expenditure of individuals in each of the 5 income quintiles

Annual Expenditure per capita grouped by Income Quintiles (Rs.)					
	Income	Income	Income	Income	Income
	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
Current Annual					
Expense	7,534	9,180	10,825	12,676	16,413

- Estimation of post-retirement corpus (for 20 years after 60) required by each income quintile for age groups from 20 55 years
- Life expectancy of 80 years
- Discount rate of 8%

# Simulating Returns on the pension fund

Annualised return	Equity (BSE Top 100)	10 yr Gov Sec	Corporate Bond	Inflation
Mean	19.30%	8.32%	9.33%	8.04%
Median	11.93%	7.96%	8.97%	8.32%
Std Dev	39.35%	1.84%	1.84%	3.67%

**Investment Mix** 



Monte Carlo simulations used for estimating returns

### **Expected Corpus under NPS-Lite**

Annual Expense, Corpus required at age of retirement, and Present			
Value of corpus required at retirement across age groups for Income			
	Quintile	1 (Rs.)	
	Annual Expense at	<b>Corpus Required</b>	
Age of Individual	Age of Retirement	at Age of	PV of Corpus
Today	(60 years)	Retirement	
20 years	163,684	3,273,687	150,691
25 years	111,401	2,228,016	150,691
30 years	75,818	1,516,350	150,691
35 years	51,600	1,032,003	150,691
40 years	35,118	702,364	150,691
45 years	23,901	478,017	150,691
50 years	16,267	325,330	150,691
55 years	11,071	221,414	150,691

An LIC Annuity bought for Rs.100,000 pays Rs.644 p.m for life, with 100% payable to spouse on death of annuitant. Annuity for Rs. 150,691 will provide a monthly annuity of Rs. 970.25 for life.

### **Design Elements of NPS-Lite**

### Inadequacy of Retirement corpus

Expected Terminal Amount and Annuity / Month with Government Contribution for			
a	period of 5 years	(Rs.)	
Age of	PV of Expected	Real Annuity	
Entry into			
NPS-S	Ierminal Amount	per Month	
20 years	31,308	201.62	
25 years	29,193	188.00	
30 years	26,378	169.88	
35 years	23,680	152.50	
40 years	21,031	135.44	
45 years	18,043	116.20	
50 years	14,689	94.60	
55 years	10,702	68.92	

This covers only 20.78% of the postretirement expenses

# Benefits from the Government Contribution

#### <u>To ensure parity for informal sector workers, Swavalamban matching Government</u> <u>contribution must continue beyond 2016-17 for perpetuity, with the Government</u> <u>contributing up to Rs. 1,000 per subscriber per year.</u>

Rationale:

- To avoid burden on public finances from imminent cash transfer programs
- To bring parity with formal sector workers (Govt contributes Rs.2088 p.a under EPS)
- To ensure adequacy of pension payouts especially for individuals who are unable to build a corpus on their own
- Govt money gets channeled back into long-term projects

### **Inflation Protection**



#### <u>Government provide inflation-index adjustment to the Government contribution at</u> <u>regular intervals. This can be linked to CPI, and revised annually</u>

### **Optimising risk-adjusted Returns**



#### Move from a conservative investment mix to an age-linked equity allocation approach as used for NPS-Main to have opportunity for creating a larger corpus

Illiquidity of NPS-Lite is an important design feature and it must not be diluted

# **Capital Guarantee**

Consistent volatility in inflation rates can potentially deplete the investment corpus

Investment Mix required for Capital Guarantee				
	(Source: CRIISP Report) (Rs.)			
Investment	Market			
Horizon	Interest	PV of Initial	Investment in	Investment
(Years)	Rate (%)	Investment	Debt	in Equity
10	7.99%	46, 355	46, 355	53, 645
15	8.32%	30, 156	30, 156	69, 844
20	8.34%	20, 130	20, 130	79, 870
25	8.40%	13, 316	13, 316	86, 681
30	8.43%	8, 821	8, 821	91, 179

<u>Capital Guarantee be made a feature of NPS-Lite by permitting a portion of corpus to be</u> <u>invested in approved fixed income instruments of specified maturities by PFMs</u>

### **Customer Protection**

Investment required per annum for ensuring			
post-retirement corpus of subscribers			
in l	ncome Quintile	1 (Rs.)	
Investment	Inflation Adjusted	Non-Inflation Adjusted	
required per annum	Contributions	Contributions	
20 years	2,364	6,539	
25 years	2,817	7,185	
30 years	3,422	7,961	
35 years	4,264	8,944	
40 years	5,516	10,292	
45 years	7,560	12,367	
50 years	11,476	16,203	
55 years	21,947	26,304	

Assumes no Government contribution; Consolidated CAGR of returns at 9.76% for current investment mix; Inflation at 8%

As a bare minimum, the optimum amount of contributions required to be made by the subscriber must be calculated and communicated to the subscriber. PFRDA could put out indicative tables for reference, arrived at based on expenditures of subscribers.

### Envisaging Outcomes in Product Design

- <u>To ensure parity for informal sector workers, Swavalamban matching</u> <u>Government contribution to continue for perpetuity</u>
- Inflation-index adjustment for Government contribution
- <u>Age-linked equity allocation approach to avail the opportunity for creating a</u> <u>larger corpus</u>
- <u>Illiquidity of NPS-Lite must not be diluted</u>
- <u>Capital Guarantee be made a feature by investing a part of in approved</u> <u>fixed income instruments</u>
- As a bare minimum, the optimum amount of contributions required to be made by a subscriber must be calculated and communicated to the subscriber

# Universalising Defined Contributions into NPS-Lite

# Leverage Aadhaar and PMJDY processes to ensure a minimum government contribution to all unorganised sector workers in an instant, equitable, and comprehensive manner

- Automate a direct conditional minimum Government contribution of Rs.1000 p.a
- The Retirement Account linked to Aadhaar, PMJDY
- The Government contribution creates a base corpus, subscriber can build on it.

Direct Seeding of retirement accounts linked to Aadhaar costs Rs.46,000 cr a year. This comes to 0.45% of current GDP

Current expenditure on public pensions is at 1.3% of GDP

This is comparable to low and medium income countries' expenditure on pensions (1.1% and 2.5% of GDP respectively).

### **Distribution Strategies for NPS-Lite**

### Improving awareness about NPS-Lite

The Committee to Review Implementation of Informal Sector Pension (CRIISP) notes

"It is by now a well-recognised reality of the Indian financial markets that most financial instruments in India are "push" products and not really "pull" products, which means that most financial instruments in the country do not enjoy an automatic demand and need to be sold proactively".

- <u>A concerted media campaign across local language newspapers, radio and television</u> <u>-the</u> <u>campaign for the National Pulse Polio Programme is a case in point.</u>
- Focus on: the importance of self-funded old age pension, the notion of market-linked returns, Swavalamban matching contribution in perpetuity, the expected pay-outs at the time of annuitisation, as well as the flexibility to make contributions at any Aggregator (inter-operability).

### **Aggregator Incentives**



CRIISP report reiterates, "... an ad valorem approach of charging the subscriber has the potential of merging the advantages of volumes (from small investors) with value (high ticket investments from rich investors)."

#### An incentive structure that provides:

- <u>Rs.100 for every subscriber who contributes a</u> <u>minimum of Rs.1000 (and no incentive</u> <u>payments for below Rs. 1000), and</u>
- an ad-valorem rate of 5% of the subscriber's contributions above Rs.1000

### Aggregator Processes and Technology





# Readiness of interface for seamless transactions

Technology Platform that enables real time interaction with NSDL-Server for all actions :

- E-KYC Authentication
- Subscriber enrolment and PRAN generation
- Subscriber contributions, systemgenerated receipts with time-stamps
- Interoperability across Aggregators
- Speedy settlement and Reconciliation
- Instant access to daily/real-time Account information even without visiting NL-CC

- PFRDA require all Aggregators to use a technology platform that provides for realtime transactions with the NSDL server for all actions listed
- <u>As a public good, PFRDA can develop,</u> package, and distribute a basic "Technology <u>Starter Pack" to all Aggregators</u>
- <u>Aggregators to adopt options like SMS,</u> <u>online verification, the \*99# NPCI/USSD</u> <u>facility and/or IVR to make available to</u> <u>subscribers, their real time account data</u> <u>from NSDL systems</u>

### **Envisaging Outcomes in Distribution Strategies**

- <u>PFRDA must undertake a concerted media campaign across local language</u> <u>newspapers, radio and television</u>
- <u>An ad valorem incentive structure that provides Rs.100 for every subscriber who</u> <u>contributes a minimum of Rs.1000 (and no incentive payments for below Rs. 1000),</u> <u>and an ad-valorem rate of 5% of the subscriber's contributions above Rs.1000.</u>
- <u>PFRDA require all Aggregators to use a technology platform that provides for real-</u> <u>time transactions with the NSDL server for all actions</u>
- <u>As a public good, PFRDA can develop, package, and distribute a basic "Technology</u> <u>Starter Pack" to all Aggregators</u>
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Thank you