The role of investment policy for pension funds

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Presentation at the Roundtable on Pensions policy in India

24 February, 2015

The context of Indian pensions reforms

- The committee on Old Age Social and Income Security (OASIS, 2000) identified three key problems in existing pension systems:
  1. Very low coverage.
  2. Civil servants system was unaffordable.
  3. Mandatory system for private workers had low returns, and failing on their redemption promises.
- Two out of the three involved the need for better thinking on investment policies.

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4. The longer the investment horizon, the more dependable the equity premium. Longer horizon, higher weight on equity.
5. Diversify home country risk through international diversification.

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3. Defined a life-cycle investment process as the default investment for the contributor who does not choose. Defined as "auto choice".
4. In the NPS auto-choice, the proposed parameters of the life-cycle process:

   A : Highest risk weights - 65% in equity, 25% in corporate bonds, 10% in government securities.
   B : Lowest risk weights - 10%-10%-80%
   C : Age range for highest risk weights - 25-35 years
   D : Age of retirement - 60.

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- Variable investment rules: index funds managed by the PFMs, active management in index securities permitted temporarily, trade in index ETFs not permitted until recently.

Tasks for pensions policy

Short term policy issues: Revert to first principles

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- Improve transparency of performance of accumulations to better incentivise individuals to persist with contributions.
- Allow the same choices of fund manager and asset allocation to all categories of contributors.
- Remain focussed on low costs through passive management in all asset classes.
- Actively change investment guidelines to include hedges against inflation and other risk management instruments.

  For example, inflation indexed instruments, interest rate derivatives, higher weights in domestic equities, international diversification.

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- Resolve capital control issues for pension funds sized investments in international markets.