Saving for retirement – the role of NPS

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Contents

Brief background on pension systems

Pension systems

- Makes and delivers on promises of regular payments in old age (after retirement).
- Types of promise: based on defined benefit (pension plan) or defined contributions (pension funds).
- Needs management
  1. of large pools of money
  2. over a very long period of time.
- A social security system on promises.
  1. Traditionally, the implicit beneficiaries – taxpayers in a defined benefit system.
  2. Today most pension systems are defined contribution.
- Pension fund management industry is a competitive market.

Policy issues

Pensions policy, old and new

- Old (now redundant) policy: Deliver defined benefit pensions.
- The pensions reforms debate in the nineties was driven by failure of defined benefit social security pension plans.
- New policy focus: All pension systems are funded.
  System must accumulate funds to ensure pension payout, where the new policy focus is
  How to deliver performance on funded pension payout
- where performance has two phases:
  1. Funds accumulation phase and
  2. Pensions payout phase.

Issues in pensions policy

Three points of policy focus in performance:

1. Investment policy:
   - Deliver high performance at low costs
     This must hold in both the *accumulation* and the *payout* phase (whereever payout is not a one-time, lumpsum event).
   - The more sophisticated the investment policy, the more governance oversight required.
2. Governance of pension fund management:
   - Managerial control of the organisations.
   - Minimise conflict of interest between those who manage the funds, and fund members
3. Access and delivery of the pension system
   - Particularly if it has to offer a successful old age security feature for the informal workforce.

The NPS initiative

Where does NPS fit?

- NPS was born in the context of
  - the global pension reforms process **and**
  - recognising India's large informal sector workforce, **and**
  - an exploding pension demand on the Indian fisc.
    - Defined benefit, EPS – mandatory, unfunded.
    - Defined contribution, EPF – mandatory, funding unknown
    - Exempt funds, private PF funds
    - Defined benefit, government pensions.

The NPS 1999 vision

1. A defined contribution plan
2. Serves as a voluntary pension fund to *any* citizen,
3. Is an individual account system – a revolution at the time, even globally
4. Can take any contribution
5. Existing financial services firms can serve as *points of presence* for funds collection and payout delivery.
6. Funds are managed through a competitive industry of fund managers – for both the accumulated funds and the annuities.
7. Note: Points of presence are independent of fund management.

Where now; where to next?

State of NPS implementation now

- Central government pensions has been NPS from January 2004.
  Various state government pensions followed over the next five years.
- Voluntary private sector NPS available from May 2009.
- Voluntary low-income worker NPS
  1. NPS-lite in 2010.
  2. Reformed as Atal Pension Yojana (APY) in 2015.
- By the start of 2017,
  - Number of subscribers reached 14.2 million.
  - AUM was Rs.1.7 trillion.

Gaps in the implementation

Several breaks with design principles:

1. Enable choice between NPS and EPFO – not fully implemented
   Lumpsum withdrawals under NPS is taxed, not under EPFO.
2. Accumulation returns – departure from indexation in investment $\rightarrow$ higher cost, lower returns.
3. Accumulation returns – partial withdrawal allowed in Budget 2017 $\rightarrow$ lower returns
4. Post retirement returns – poor annuity performance on the 40% mandatory annuitisation.

Other challenges in implementation

- Policy change needs time to set in.

  Too early to comment on problems based on end performance?
- Deeper problem with frequent policy interventions – makes it difficult to understand if the policy is working or not.
- Wide coverage objective yet to be achieved.

  Total civil workforce = 474 million (NSS, 2011-12)

  Covered workforce = 58 million (from Economic Survey and EPFO estimates, 2011-2012)
- But resultant interventions have not helped.
  - Example: NPS-Lite replaced by APY $\rightarrow$ confusion among the target audience.
  - Example: incentivising distribution $\rightarrow$ relapse into the regime of higher probability of mis-selling and lower customer protection.
- No focus on developing a competitive, well-functioning market for annuities.

Summary

- NPS remains a potentially great long term savings product. *In search of inclusion: informal sector participation in a voluntary, defined contribution pension system* by Sane and Thomas, 2015
  Documents that low-income households contribute to NPS **and** contribute regularly.
- Ideally, coverage has to be higher.
- Indian savings is skewed into non-financial assets. *The Indian household finance landscape* by Badarinza, Balasubramaniam and Ramadorai, 2016.
- Frequent interventions make it troublesome to evaluate impact *and* confuse the target audience.
- More policy discussion and careful design (linked to stated and observed outcomes) is needed.
- This can help achieve the end goal of pension systems.

Thanks

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