Pension reforms

2.45 The problems associated with the ageing of populations afflict not only the developed countries but also emerging economies with varying intensities. As a country's population ages, the economy's capacity to sustain the higher elderly population needs to be enhanced. India is fortunately better placed in terms of demographic profile and richer through the experiences of other countries' pension reforms. In the next 20 years, a substantial decline in the dependency ratio is expected with a large number of people coming into the labour force. The time is opportune for the creation of a modern and sustainable pension system. Given the increase in life expectancy, in the foreseeable future, a large part of the population will also be past the working age. With improved medical facilities, this number would only increase over time. An average retired person is expected to draw pension for at least 17 years. Given this scenario, a worker would have to save enough to last for nearly two decades after retirement.

2.46 With some exceptions like the National Old Age Pension Scheme, social protection is practically non-existent for a large majority of the population. Pension benefits are not available to about 87 per cent of the population and 74 per cent of the work force, the bulk of whom are in the unorganised sector. With the absence of a choice to individuals and lack of portability, there is a limitation on the mobility of labour.

Pension reform initiatives

2.47 India has embarked on the path of pension reforms after an extensive process of discussion and policy debate starting from 1998 and several Budget announcements to this effect. The new pension system (NPS) is the outcome of the policy efforts and recommendations of Project OASIS (Old Age Social and Income Security) of the Ministry of Social Justice and Empowerment, of a Ministry of Finance Working Group on this subject, and a high level expert group headed by Shri B.K. Bhattacharya. After examining these reports, NPS was implemented for Central Government employees (excluding defence personnel) recruited on or after April 1, 2004. The NPS architecture is designed for scalability, outreach, fairplay and low cost, and provides choices to individual participants. For such a system, a sound regulatory framework is an imperative. The NPS envisages individual retirement-based accounts, with the worker empowered to exercise investment choice. There are features such as full portability and flexible switching in the hands of the workers. It is important to note that the scalability of the NPS extends to cover even the low-paid unorganized workers. In the past all attempts to provide social security to low-paid workers have failed mainly because of problems in the delivery mechanism. Already over 1,00,000 employees of the Central Government are mandatorily covered under the system and about 15 State Governments have notified defined-contribution pension systems based on the NPS.

2.48 The Budget for 2004-2005 announced that suitable legislation to provide a regulatory framework for the scheme would be introduced in Parliament. Accordingly, the Pension Fund Regulatory and Development Authority Ordinance, 2004 was promulgated on December 29, 2004. A Bill replacing the Ordinance was introduced in Parliament on March 21, 2005. The Bill was referred to the Standing Committee on Finance. The Committee presented their report in Parliament on July 26, 2005. The recommendations of the Committee, inter alia, include:

(i) allowing withdrawal from Tier I account[2] also;

(ii) specifying in clear terms in the Bill that one of the pension funds would be from the public sector;

(iii) giving preference in selection to such pension fund managers that guarantee returns, and spelling out the pre-

[2] **Tier-I account:** This is the account into which the mandatory monthly contribution under the NPS by the employee, the matching contribution by Government and investment returns would be deposited. Withdrawals would not be permitted from this account.

Tier-II account: In addition to the non-withdrawable pension Tier-I account, each individual may also voluntarily opt for another account called Tier-II account from which he/she would be free to withdraw a part or all of his Tier-II money. This option is to be given as General Provident Fund would no longer be available to new recruits to Government service with effect from January 1, 2004. Government would not make any contribution to this account.

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requisites relating to capital structure and experience criteria for selection of pension funds and other intermediaries in the Bill;

(iv) making available to subscribers an option of 100 per cent investment in Government securities and indicating this in the Bill;

(v) stipulating that any decision relating to permitting FDI in the pension sector should be implemented only by way of suitable amendments in the legislation; and further that such decisions and decisions relating to deployment of pension funds outside the country should not be at variance with related provisions applicable to the insurance sector;

(vi) including the differentiation between Tier-I and Tier II accounts as a part of the basic or essential features of the NPS in clause 20 of the Bill; and

(vii) bringing forward a comprehensive legislation in order to cater to the social security of the unorganized sector, inclusive of pension coverage of the workforce simultaneously with the setting up of PFRDA as a statutory body.

The recommendations of the Committee have been examined and a proposal for amending the PFRDA Bill, 2005, based on the recommendations of the Committee is under the Government's consideration.