Pension reforms in India

2.48 In the years to come, poverty amongst the elderly may be the dominant form of poverty in the country, given the breakdown of the joint family, increasing life expectancy, increasing migration flows of labour within the country, and the limited effectiveness of poverty-alleviation programmes – such as employment guarantee schemes – in targeting the elderly. A modern pension system will lay sound foundations of financial portfolios through which individuals will be able to obtain income support in old age. Pension funds are natural vehicles for long-term investment, including in equity. A modern, well-regulated pension sector, populated with professional pension fund managers, will also be a highly beneficial force in India's financial system, and improve resource flows in the form of long-term debt and equity to sound projects, particularly in infrastructure. The pension sector can also be a major customer of insurance companies for the purpose of converting a stock of pension wealth at retirement date into a flow of monthly pensions in the form of 'annuities'.

Objectives of pension reform in India

2.49 Global pension reform experience over the past 10 years has shown that "no one size fits all". However, the two main aims of pension systems everywhere remain the same, namely; (i) reducing poverty and eliminating the risk of rapidly falling living standards post-retirement, and (ii) the broader goal of protecting the elderly from economic and social crisis.

2.50 India needs a pension system which is: self-sustainable; universally accessible, especially to the uncovered unorganised sector workers on a voluntary basis; low-cost, efficient and available throughout the country; equitable and pro-labour and does not inhibit labour mobility; and well-regulated in order to protect the interests of subscribers. On August 23, 2003, Government decided to introduce a new restructured defined contribution pension system for new entrants to Central Government service, except to Armed Forces, in the first stage, replacing the existing defined benefit system. Subsequently, the New Pension System (NPS) was operationalised from January 1, 2004 through a notification dated December 22, 2003. The main features of the NPS are:

- It is based on defined contribution. New entrants to Central Government service contribute 10 per cent of their salary and dearness allowance (DA), which is matched by the Central Government (Tier-I).

- Once the NPS architecture is fully in place, employees will have the option of a voluntary (Tier-II) withdrawable account in the absence of the facility of General Provident Fund (GPF). Government will make no contribution to this account.

- Employees will normally exit the system at or after the age of 60 years. At the time of exit, it is mandatory for them to invest 40 per cent of the pension wealth to purchase an annuity to provide for lifetime pension of the employee and his dependent parents and spouse. Remaining 60 per cent of pension wealth will be paid to the employee in lump sum at the time of exit. Individuals would have the flexibility to leave the pension system prior to age 60. However, in this case, mandatory annuitisation would be 80 per cent of the pension wealth.

- The new system will have a central record keeping and accounting infrastructure and several fund managers to offer investment options with varying proportions of investment in fixed-income instruments and equity.

- The new system will also have a market mechanism (without any contingent liability) through which certain investment protection guarantees would be offered for the different schemes.

2.51 An interim regulator, the Pension Fund Regulatory and Development Authority (PFRDA) was constituted through a Government resolution dated October 10, 2003 as a precursor to a statutory regulator and became operational from January 1, 2004.

2.52 Till the architecture is fully in place, the Central Pension Accounting Office (CPAO) under the Controller General of Accounts is acting as the interim Central Record-keeping Agency (CRA). Contributions are currently being credited into the public account earning a return equal to the GPF rate. As per data available, about 137,952 employees are covered under the NPS. Approximately Rs. 200 crore, including Government contribution, has been credited into the pension account. The Pension Fund Regulatory and Development Authority Bill, 2005 was introduced in Parliament on March 21, 2005. The Bill proposes that the main mandate of PFRDA is to regulate the NPS, as amended from time to time by the Central Government. Pension schemes already covered under the Employees' Provident Fund & Miscellaneous Provisions Act, 1952 and other enactments would be specifically excluded from the regulatory jurisdiction of PFRDA. However, individuals covered under such mandatory programmes under other Acts can voluntarily choose to additionally participate in the NPS.

2.53 PFRDA will establish the institutional architecture of the NPS including the CRA and pension funds. It will also frame investment guidelines for pension funds. PFRDA is empowered to impose stringent penalties for any violation of the law. The regulator will also create a special fund, which will be used for educating and protecting the interests of subscribers to schemes of pension funds. The Bill was referred to the Standing Committee on Finance. The Committee presented their report in Parliament on July 26, 2005 recommending:

(i) allowing withdrawal from Tier I account 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-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) implementing any decision relating to permitting FDI in the pension sector only by way of suitable amendments in the legislation; and not allowing such decisions and decisions relating to deployment of pension funds outside the country to be at variance with related provisions applicable to the insurance sector;

(vi) setting up a Pension Advisory Committee similar to the Insurance Advisory Committee of IRDA;

(vii) rephrasing clause 4 of the Bill to clearly depict the composition of the Authority; selecting members of the Authority only from amongst professionals having experience in economics or finance or law; and having a Central Government nominee as one of the part-time members;

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

(ix) 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.

A proposal to amend the PFRDA Bill, 2005, based on the recommendations of the Committee is under Government's consideration.

2.54 Ministry of Finance convened a conference of Chief Ministers and State Finance Ministers on January 22, 2007. Majority of the State Government participants generally welcomed the move towards a fiscally sustainable pension system for civil servants and the establishment of an old age income security system for all Indians. Following the lead of the Central Government, 17 States have notified a defined contribution pension system for their new employees. In the conferenc, States were assured that the PFRDA Bill will be amended to provide an option for investing 100 per cent of pension funds in government securities, entrusting the job of fund management initially only to public sector fund managers, etc. The investment pattern for non-government provident funds, while conservative and restrictive, would be adopted as an interim model, pending the passage of the PFRDA Bill.