

Pension and other retirement benefits a view on India

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Index

Index	2
Executive Summary	3
Indian demographics:	6
Indian Pension “Reforms” – Passages:	
Passage 1: Pre- PFRDA Bill, 2005 (21 03 2005)	9
Passage 2: The Pension Fund Regulatory and Development Authority Bill, 2005 (PFRDA Bill 2005)	13
Indian Pension Reforms – Current Realities	22
Accounting for Employee Benefits	24
Acknowledgements	28
Annexure 1: Functions and responsibilities of Participants in the New Pension System	29
Annexure 2: The institutional architecture of the New Pension System:	35
About the Author:	36

Executive Summary

- 1) India does not have a national level Pension and Social Security system (Pillar 1), however, for corporate employed sector population, statutory lump sum retirement benefits in two forms; the Provident Fund (DC) and the Gratuity (DB) exists (Pillar 2).
- 2) The voluntary pension (superannuation) funded provision (Pillar 2) by employers (DC and/or DB) is facilitated through tax incentivisation, but of late has been under pressure on account of Service Tax on employer's contribution and employment related emerging issues.
- 3) The unorganised "small and self employed population" do not have statutory framework within which retirement benefits can be funded (Pillar 1).
- 4) The central Government in 1998 took initiatives for putting in place a pension system for small and unorganised working population (Pillar 1). The initiative in the form of a Committee to examine issues and suggest ways called Old Age Social and Income Security (OASIS) made recommendations some three years down the line, though missing the original objectives (Pillar 1) it focussed on the organised employed sector (Pillar 2 and 3).

As a consequence of above;

- a) In the Budget for 2003-04, Government announced the introduction of a defined contribution (DC) pension system applicable, in the first stage, to new entrants to Government service, except Defence Services. Accordingly, the New Pension System (NPS) was introduced from January 1, 2004 for Central Government employees recruited on or after that date. The NPS in principle, is available, to the Employees of those State Governments which opt to be part of it (operationalised) and on a voluntary basis (not yet operationalised), to all persons including self-employed professionals and others in the "unorganized sector".
- b) The Pension Fund Regulatory and Development Authority (PFRDA) Bill 2005 proposed to actualise the above objectives of the Government, was referred to the Standing Committee on Finance. The Standing Committee has recommended that important issues like minimum capital requirement for Pension Fund Managers (PFMs), foreign equity in PFMs, issue of guarantees to the subscribers, withdrawals from pension accumulation, and decisions on public sector PFM and selection criteria for PFM be spelt out in the Act. The government will now

have to reintroduce the PFRDA Bill in the parliament taking into consideration the recommendations of standing committee.

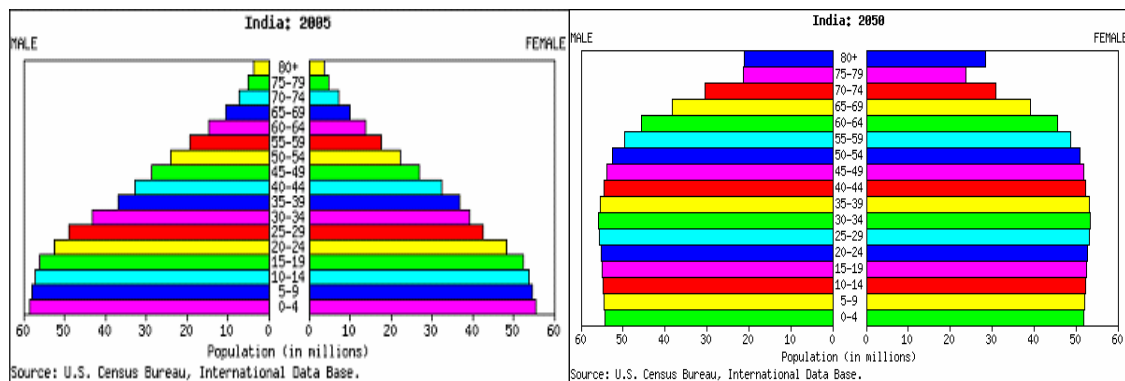
- c) The PFRDA Bill is unlikely to be enacted in near future on account of opposition to it from certain quarters mainly left and left oriented political parties. Such opposition initially for abolition of Defined Benefit Scheme (DBS) for the Government employees appears to have settled down to, mainly, structure of PFMs to the extent that it relates to their foreign ownership.
- 5) The activities of those having stake in these matters have got centered on what is perceived by public, wrongly though, “Pension Reform Initiatives” of the Government. The conclusive part of the OASIS Report and what has followed out of PFRDA Bill 2005 has no element of “reforms” on what exists now but what it proposes is;
 - i) move from DB to Defined Contribution Scheme (DC) for Government employees and
 - ii) individual Account based scheme called National Pension Scheme (NPS) for economically active, employed and self-employed, population (Pillar 3).
- 6) Stake of the Life Insurance Industry (opened to Private Sector participation in Y 2000) in the current “pension reforms initiatives” are:
 - a) Opportunities to operate as PFM
 - b) Opportunities to be annuity provider
 - c) Opportunity to be part of independent retirement advisor through its distribution system
 - d) Opportunity to be part of Point of Presence (PoP) network.
- 7) The Life Insurers have been lobbying for roles such as PFMs and PoPs, however, there is a view likely to carry the day that they should be confined to the role of annuity providers only. It is also likely that some Mutual funds like UTI Mutual Fund and others in the Public Sector may also be allowed to provide annuities. This surely will take away the monopoly of life insurers in the annuity market, but given the Insurance Act, 1938 provisions, the Government will have to make legislative amendments for this to happen.
- 8) It is perceived that the insurance Regulator (IRDA) is unlikely to accept that any part of activity of an insurer is regulated by any other regulator. For example if Life Insurers are allowed to directly or indirectly own PFMs, such function then will have to be regulated by PFRDA, which would then be construed as encroaching upon the jurisdiction of IRDA. Similarly if Institutions other than Life Insurers that are enabled to provide annuities, will have to be regulated by PFRDA to the discomfort of IRDA. A situation such as this has huge potential of regulatory arbitrage leading to diminished level of customer protection.

- 9) Even if the PFRDA Bill becomes an Act, it is unlikely to be extended in near proximity thereafter to unorganised sector individual contributors.
- 10) Tangible opportunities for life insurers to participate in the pensions arena, short, medium and long term would appear to be;
 - a) In the short term, the same as of now. Even in near proximity to the PFRDA becoming reality, such opportunity as it exists to day is not likely to change.
 - b) In the medium term, the opportunities as annuity providers will surely increase as well as working as PoPs in competition with Banks and Post Offices.
 - c) In the long term, the scenarios are rather too hazy to be of much value now. Much will depend upon what will flow out of happenings in the short to medium term.
- 11) The focus of the government has been, unfortunately, on issues of immediate concern to itself as an employer and no action on what can be achieved by reforming the existing Pillar 2 Pension systems and/or introducing Pillar 1.
- 12) It is perceived that the government does not have necessary political will or even inclination to initiate action either on Pillar 1 or reform on Pillar 2.
- 13) Accounting Standards for reporting of Employee Benefits cost in the financial statement of employers shape the provisioning of the same by the employers. Since 1995, there has existed Accounting Standard 15 (AS 15) relating to Retirement Benefit costs. This however was simplistic in number of ways and in any case did not cover the whole of employee benefits. On the lines of International Accounting Standard 19, the AS 15 has been revised as Accounting Standards for Employee Benefits, AS 15 (rev.2005) and covers all the employee benefits. Its implementation though, opposed by number of industry sectors particularly the Public Sector Banks has taken a back seat.
- 14) The Actuarial Practice Standards (called Guidance Notes by the Indian Actuarial Profession) relating to actuarial reporting of costs, though in place since 1999, has been ineffective in its implementation and its revision to match the AS 15 (rev 2005) has taken back seat as well.

Indian demographics

Some aspects of Indian demographics and results of a Survey that Watson Wyatt carried out in early part of year 2006 on Employers' understanding of Retirement Benefits of their companies in particular and in India, generally, is relevant to mention here.

“India’s population is ageing steadily. It is estimated that by 2050, the number of people in India aged 50 and above will be one of the largest in the world. Based on projections by the US Census Bureau, 32.8% of the entire population in India will be 50 and above by 2050. In 2000, this figure was only 14.1% of the entire population. In absolute terms, the number of people aged 50 and above will increase from 141 million in 2000 to more than half a billion by 2050. “



“This fundamental change in India’s demographics will have far-reaching consequences for the economy and companies operating in India. As the Indian workforce ages, employers will increasingly find a need to hire older workers and to keep them in the workforce longer, as long as they remain productive. As a result, healthcare and retirement needs are anticipated to increase. Nevertheless, this can also lead to retirement and healthcare benefits being a leverage which employers can utilise to successfully attract and retain more qualified and competent employees. Indeed, the major HR challenge facing companies in India is not in recruiting, but in the retention of talent in a growth market.”

“It is often perceived that given the sheer size of India’s workforce, corporate decision-makers need not deal with the problems brought on by an ageing workforce for the foreseeable future. Yet, this perception overlooks the fact that income from statutory retirement plans is inadequate for employees to maintain a basic standard of living after retirement, and that public healthcare services are inadequate to meet employees’ basic healthcare needs. “

“....., given the Indian government’s burgeoning fiscal deficit and rising government borrowings, it is foreseeable that companies will have to play a key role in meeting the retirement and healthcare needs of their employees as the workforce ages in the next 15 to 20 years. But the ageing of India’s workforce may also present an opportunity for employers. In fact, research by Watson Wyatt strongly suggests that a well-designed retirement and healthcare scheme will greatly enhance the ability of companies in India to attract and retain the most qualified and competent employees. As global competition intensifies

amongst companies, Human Capital strategies that take into account demographic changes will be crucial to ensuring corporate survival & profitability.”

An Ageing Workforce and Retirement Benefits Provision

“The phenomenon of an ageing population is observed in many developed and developing countries, and the underlying causes are similar. They are: an elongated life expectancy rate and a declining birth rate. The Asia-Pacific region in particular, is ageing and India is no exception. In India, life expectancy at birth was only 57.2 years in 1990 but this number is expected to increase to 77 years by 2050. On the other hand, the birth rate will decline from 31 babies per thousand in 1992 to only 13 babies per thousand by 2050 (U.S. Census Bureau).”

“....., like many developing countries, India still lacks a comprehensive social system to protect retirees from financial insecurity. Currently, almost 90 percent of India’s workforce does not participate in any formal retirement benefits scheme. For the remaining 10 percent, the existing statutory retirement benefits scheme was originally designed for a workforce that retires at 60 and has an average lifespan of 65. However, as the mortality characteristics of the Indian workforce improve and approach those of OECD countries, it is apparent that the existing statutory retirement benefits system is unsustainable and insufficient. “

“Besides the inadequacy of the existing statutory retirement benefits system, financial security for retirees in India is also being threatened by a breakdown of traditional family support whereby the elderly live with their children and receive financial support and care from them. Due to increased labour mobility, workers now are more likely to find employment at distant locations that preclude them from living with their elderly. Increasingly, Indians are realising that they need to be more financially independent when they retire as the nucleus family unravels. “

“Given these factors, it is foreseeable that an ageing workforce in India will drive demand for additional retirement and healthcare benefits. Therefore, it makes good business sense for employers to implement strategies now to manage an ageing workforce, and even capitalise on the situation to enhance their companies’ overall competitiveness. “

Survey Summary

Although healthcare and retirement benefits receive moderate attention from employers in India, as compared to some other Asia-Pacific countries, the reform of healthcare and retirement benefits (Pensions) system is an issue under discussion by the Indian government and policy think-tanks. As the life expectancy increases for the whole population, the increasing need of healthcare and retirement benefits will become a

serious problem faced by the Indian government and employers. 53% of employers choose “Ageing Population” as the most significant demographic change for India over the next 15-20 years. More than half of them show serious concerns for the sustainability of statutory healthcare and retirement benefits system. The Indian government and employers need to do more to satisfy the increasing needs from employees, while keeping the system sustainable.

A: Impact of Demographic Changes

- 1) Most employers think that employees’ appreciation of healthcare and retirement benefits will increase over the next 15-20 years, with the percentage being 73% and 65% for healthcare and retirement benefits, respectively.
- 2) To address the demographic changes over the next 5-10 years, companies are in the process of introducing new benefits or increasing existing benefits for retirement (73%), healthcare (74%) and post-retirement healthcare (65%) needs. About 60% of the employers think employees need to share the cost with employers.
- 3) “Passing legislation to encourage supplementary benefits provision” (56%) and “providing tax incentives for supplementary benefits provision” (55%) are the two most important actions that employers think the government needs to take in meeting the increased healthcare and retirement needs.

B: Retirement Benefits Issues

- 1) Although 56% of the employers are of the view that the company has an obligation to help employees save enough in their retirement accounts, 55% of them think the employees should bear all the investment return risk in their retirement funds.
- 2) 67% of the employers claim that their companies provide supplementary retirement benefits to their employees. However, a moderate percent of these employers believe that their supplementary retirement benefits help to attract (48%) and retain (43%) high-performing employees.
- 3) 50% of supplementary retirement benefits schemes are Defined Benefits (DB), while Defined Contribution (DC) and Hybrid Retirement Benefits account for 33% and 17%, respectively. In line with the global trend of transforming retirement schemes to DC type, 51% of companies are taking actions to change their current schemes to a DC scheme.
- 4) As to the impact of Fringe Benefits Tax on the company’s superannuation fund provided to employees, 57% of employers will not change the benefits while 10% will think about closing the benefits to new entrants. 36% of them will modify the pension schemes to reduce contributions. Only 2% of employers will think about winding-up the benefits.

Indian Pension “Reforms” – Passages

Passage 1: Pre- PFRDA Bill, 2005 (21 03 2005)

OASIS Phase I

Government of India, in the Ministry of Social Justice and Empowerment, constituted an Expert Committee under Project OASIS (Old Age Social and Income Security) in 1998 with the basic mandate, “to make concrete recommendations for actions which the Government of India can take today, so that every young person can genuinely build up a stock of wealth through his or her working life, which would serve as a shield against poverty in old age.” **This clearly implied Pillar 1 and Pillar 3 arrangements.**

The OASIS Committee submitted its Phase - 1 report on 01 02 1999 covering existing mechanism for Social Security as well:

- 1) Provident Funds
- 2) Pension Schemes, and
- 3) Public Provident Funds

Some of the issues that this report dealt with and made recommendations on are:

- 1) The Government should encourage fully funded old age income social security system that emphasizes the values of thrift and self-help.
- 2) The existing Provident Funds and pension programmes do not adequately solve the problem of income security in old age.
- 3) The contribution rates of workers are already amongst highest in the world.
- 4) The weakness of the existing schemes, lie in low rates of return and poor accumulation.
- 5) To tackle the problem of increasing longevity, there should be access to competitive market for annuities.
- 6) Contributions as well as interest earned are not taxed both in case of pensions and provident funds. But pensions in the hands receivers are taxed whereas Provident Funds (including PPF) are not. This is a disincentive for contributory pension schemes and needs to be rectified. There is a strong justification to tax receipts of accumulated Provident Funds.
- 7) The report made number of recommendations relating to Investment, administration and benefit structure for Provident funds falling under Employees’ Provident Fund Organisation

(EPFO), The Public Provident Fund (PPF) and Employees' Pension Scheme 1995 (EPS 95). It should be mentioned here that PFs under EPFO are statutorily mandated, the PPF are voluntary and EPS '95 is integral part of EPFO.

- 8) Dealing with Annuities it recommended - Annuity Provision will be more efficiently achieved by a market with competing annuity providers. The Government should work towards obtaining a thriving, competitive annuity market where private, public and foreign firms compete in selling the cheapest annuities.

Note:

- 1) The time that this Report came out (Feb. 1999), the Insurance Sector was not opened to Private Sector participation.
- 2) The only Life Insurer then – LIC was selling annuity products but for variety of reasons, these products were rarely sold and public largely was not aware of.
- 3) The only connect with life insurance that this report dealt with was provision of annuities.
- 4) The report created controversies leading to lot of debate in various sections including the Employees' Provident Fund Organisation (EPFO) and the controlling Ministry – Ministry of Labour, taking a position that the OASIS Committee had no jurisdiction to comment on PF systems and the Employees' Pension Scheme (EPS, '95) administered by it.
- 5) **The Committee indeed had no jurisdiction to comment on EPFO and instead of focussing on it's basic objectives of Pillar 1 and Pillar 3, it diverted its attention to Pillar 2 but without attending to its inadequacies such as lack of regulatory mechanism including non-existence of Ombudman and benefit protection mechanism in the event of employer insolvencies or frauds.**

OASIS Phase II

The Phase II (final) report was submitted on 11 01 2000 and it described its objectives as, **“to recommend a pension system which can be used by individualswhich enables them to attain old age security at the price of modest contribution rates through their working career. It is simple and convenient to use and has the capability for converting modest contributions into reasonably large and comfortable sums in an almost risk-free manner for old age security.”**

This report made number of recommendations;

- 1) A New Pension System (NPS): A person to open a single Individual Retirement Account (IRA) such account to have a unique number for life into which regular contributions will be made.

On retirement the individual should be required to use the **accumulated assets to buy annuities from annuity providers.**

- 2) NPS to be supported by Point of Presence (PoPs) to be located all over India to include Banks and Post Offices. PoPs will be visited by the Account holder to carry out transactions.
- 3) The PoPs to be connected through a Centralised Record keeping Agency (CRA).
- 4) The CRA will pass on the contribution to the Pension Fund Managers (PFMs) for investment management.
- 5) Retirement Advisors to advise individuals on number of issues including selection of pension schemes of and on the PFMs.
- 6) Creation of a regulatory Authority called Indian Pensions Authority (IPA) to regulate the system.
- 7) The report identified Intermediaries as; PoPs, PFMs, Depository and Annuity Providers.
- 8) It recommended in respect of Annuity Providers, “Banks or PFMs.....can become annuity providers. In addition, insurance companies authorized to be in life insurance by IRDA and domestic financial institutions would also be permitted to sell annuities.”

Aside from the above aspects, the report dealt with “Reforms to Existing Provisions”:

- 1) Reforms to Employees’ Provident Fund.
- 2) Reforms to Employees’ Pension Scheme, ‘95
- 3) Reforms to Public Provident Fund

In respect of the first two, the EPFO and the controlling Ministry, Ministry of Labour again took the stand that the OASIS Committee did not have jurisdiction over them and no information or data was provided to the committee and wondered as to how without such information/data comments were made by the Committee.

This report had a surprise entry not connected with its frame of reference in a small para dealing with “**Government Pension Scheme**”. It stated, “**It is important that Central Government and State Government Employees are covered by a pension provision that provides significant income security during old age. While the Committee does not have adequate information regarding the funding of this provision, it appears that this provision is not fully funded and could pose a serious problem. In the light of increasing longevity in India and possible decline in number of Government employees, this provision can impose a serious strain on future Government finances.....The Committee would only recommend that measures should be taken so that Government Pension Liabilities become fully funded out of contributions made by the employees....**”

Note:

- 1) As we will notice much later, this Report became the basis for the PFRDA Bill, 2005 (21 03 2005) with focus only on the Contributory Pension Scheme for Central Government employees.
- 2) The Central Government picked the above recommendation to stop the DB scheme – maximum of 50% final average salary – for all new hires effective 01 01 2004.
- 3) Thus for new employees the Government as employer not only relinquished its responsibilities of providing income after retirement but also has put at risk the savings (mandatory as employment condition) of employees at vagaries of investment risks.
- 4) The DBS of Government employees which was unfunded (as historically such government schemes have been) and which lack of funding has started biting the system, the OASIS report instead of suggesting a system of funding, ended up abolishing the pension security itself. As it turned out the Government used the OASIS committee to recommend this which later on became its obsession forgetting the Pillar 1 and Pillar 3 aspects of the Social Security and governmental responsibilities in this regard.
- 5) This report generated lot of interest amongst life insurers as the insurance sector got opened to private sector participation (Dec. 2,000). However, the life insurers exhibited their potential interest in being PFMs more rather than annuity providers.

The IRDA Report on Pension Scheme (Nov. 2001)

While the debate amongst various stakeholders was going on the OASIS Report submitted in Jan. 2,000, the Minister of Finance in Budget speech in Feb. 2001 announced the appointment of a Committee to be constituted by the Insurance Regulator, IRDA to examine the Pension issue and come up with a Report.

The IRDA report, suggested **“a pension scheme which is voluntary in nature to be contributed by members of the un-organised sector and capable of absorbing all others who want to participate in it.”**

Details apart, it recommended a pension system i e defined contribution like the one recommended by OASIS Committee, however on the question of Annuity providers and regulatory matters it suggested;

- 1) “Paying of the annuity to the subscriber contributor will have to be exclusively handled by a life insurance company.”
- 2) “The IRDA feels that the regulation of the pension sector could be handled by the IRDA.

Passage 2: The Pension Fund Regulatory and Development Authority Bill, 2005 (PFRDA Bill 2005)

INTRODUCTION AND STATUS OF THE PFRDA BILL AND NEW PENSION SYSTEM (NPS)

In brief, the PRFDA Bill provides for the establishment of a statutory Authority to promote old-age income security by establishing, developing and regulating pension funds and matters pertaining thereto, while protecting the interests of subscribers to the pension fund schemes. PFRDA will regulate pension intermediaries with specific responsibilities and functions (Annexure1). PFRDA will approve the terms and conditions of the pension funds, their investment guidelines and provide a robust regulatory umbrella, which is necessary to sustain the confidence of the participants and protect their interests. The Bill provides for penalties, for those who violate the provisions of legislation and regulations to be made thereunder.

The new pension system was introduced by the central government for its employees w.e.f. 1/1/2004, budget announcement was also made to make a legislative basis for the same. Accordingly, PFRDA ordinance 2004 was notified on 29/12/2004. This ordinance was replaced by the PFRDA bill, 2005 introduced in the parliament on 21/3/2005 and the bill was referred to the committee on finance on 24/3/2005 for examination and report to the Parliament

The standing committee made extensive examinations of the bill and also heard the views of the Finance ministry, PFRDA, IRDA, Chambers and other stakeholders and made recommendations.

The recommendations of the standing committee had been examined by the government and the PFRDA. The govt. is building up consensus of political parties and then it will introduce the revised PFRDA bill in the parliament. A draft regulation for registration of the intermediaries was notified by the PFRDA in sept'2005, comments received thereon after examination would be made public when the revised draft of the regulations is made public after the bill is passed. The NPS stands implemented for the central government employees being a mandatory provision forming part of the rules/government notifications. About 17 states have also made it mandatory for its employees w.e.f. 1/1/2004. The efforts are being made that this NPS may be made mandatory for the centre and state government's autonomous bodies as well. Efforts are also being made that the contributions of the employees may be taken care through a record keeping agency set up for this purpose before the bill is passed. This may also involve investment of these funds through a public sector fund manager either already in operation or newly established whereas the functions of Points of Presence (POPs) can be attended by drawing and disbursing officers of the govt.

The voluntary sector, i.e., unorganized and self employed is not covered by mandatory NPS and law is needed for the same. Till the law is made, Life Insurers and Mutual Funds are attempting to cover the voluntary sector for pension funds under their existing portfolio within framework of the respective regulators.

RECOMMENDATIONS OF THE STANDING COMMITTEE:

Main recommendations of the Standing Committee are detailed below along with the title and reference of the clause of the proposed PFRDA Bill.

Clause 3: Reference to establishment and incorporation of the Authority:

- The reform, in the opinion of the Committee, and the reform process involving setting up of PFRDA for managing the NPS is an urgent necessity. The urgent necessity is mainly on account of burgeoning fiscal stress of pension payment of the centre and state revenues.
- That there is a need to provide a viable alternative to populace at large to save for old age income security.
- The Committee recorded the fact that the positive effect of lessening the fiscal stress on the central revenues on account of switch over to NPS is to be witnessed probably only after the year 2038.
- Committee also added that apprehensions expressed by concerned sections on NPS are born out of genuine concerns.
- The Committee felt that these apprehensions can be minimized, if not totally eliminated, if proper safeguards are introduced in the larger interest of subscribers – both government employees compulsorily covered as well as others.
- Committee considered the Bill clause wise, approved the same for enactment subject to modifications/ amendments/ recommendations as are stated in the relevant paras in the report.

Clause 4 (pertaining to composition of Authority):

The above provision conveys that Authority shall include two part time members, yet the qualifications required for selection have not been provided in this clause.

With a view to provide clarity, Committee recommended that this clause be rephrased to clearly depict the composition of the Authority viz.: (a) a Chairperson (b) not more than 3 whole-time members and (c) not more than two part time members.

- The Committee further desired that selection of both whole time and part-time members should be confined to professionals having experience in economics or finance or law only.
- Committee was also of the opinion that if government so desires, one of the part-time members could be their nominee.

Clause 14 (dealing with duties, powers and functions of Authority):

With specific reference to subscribers' interest, committee noted that various duties and functions are confined to establishing a mechanism for redressing grievances of subscribers which are to be determined by regulations. It also provides power to make panel or remedial measures against the intermediaries, if needed, in the interest of subscribers. Committee felt these are in very general term as one among the duties and functions of the Authority.

In view of the fact that vast powers are going to be bestowed upon PFRDA, the Committee are of the view that with specific reference to matters relating to protection of subscribers interest, the following aspects should inter-alia be inserted in clause 14:

- Ensuring safety of the subscribers' contributions to various pension schemes and funds under the New Pension System;
- Ensuring payment of benefits or returns in accordance with guarantees, if any, attached to the pension schemes or investment options chosen; and
- Ensuring that the intermediation and other operational costs under the New Pension System do not have an adverse bearing on the returns to the subscribers."

Clause 20 (dealing with features of NPS):

Committee noted that while notification of MoF dated 22.12.2003 clearly differentiated between the non-withdrawable Tier-1 account (which is mandatory

for all new recruits with effect from 1.1.2004) and the voluntary Tier-2, the same has not been depicted in the basic features of the NPS shown under the clause.

- As per government notification, the optional or voluntary tier-2 withdrawable account to which the government would not make any contribution has been designed on account of discontinuation of the GPF subscription to the new recruits.
- The Committee note that the differentiation between compulsory Tier-1 (from which withdrawals are not permissible) and voluntary Tier-2 account (which has been designed in lieu of discontinuation of GPF subscription for new recruits for enabling withdrawals when needed) has not been included as part of basic features of the NPS listed in clause 20. Committee opined that this differentiation between the two types of accounts needs to be included as a part of the basic essential features of NPS in clause 20.
- Committee opined that while the principal notification (22-12-2003) of the government may have to be amended from time to time due to operational or other reasons, the basic or essential features of the pension system should not be permitted to be alterable.
- NPS provides for non withdrawable and compulsory tier-1 account and also for a voluntary tier-2 account for a government servant. Anyone who wants to have a withdrawable facility has to opt for tier-2 account also. The Committee viewed that this would be an additional burden particularly to group D employees and , therefore, desired that even in case of tier-1 account, an element of flexibility should be provided to enable the subscriber to withdraw moneys to meet unforeseen and urgent expenses. Examples of such withdrawals could be to take one repayable advance after completion of 10 years and also permanently withdraw upto 50% of one's contributions after completion of minimum 25 years of service to meet expenses on exigencies. These examples and exigencies should be appropriately listed in the regulations.
- Major source of apprehension, witnessed by the Committee during the deliberations, is the fact that as per clause 20(f), the returns would be solely based on market performance and guarantees. It was contended that NPS seeks to deprive government employees

of their old age social security guarantee by way of statutory pension which is considered the best social security measure.

- Chairman, PFRDA informed the Committee that the government had an open mind on providing for a pension scheme or option under NPS involving 100% investment in government securities.
- Chairman, PFRDA also stated the following on the question of guaranteeing returns or benefits to the subscribers:

“Greater the competition, some pension managers on their own will provide some element of guarantee. Greater the competition, guarantees will automatically come in the system. If the market forces are allowed to play, guarantees will automatically come in the form of either the principal i.e. guaranteed or the nominal returns are guaranteed. That will automatically come. But we are open to the idea of the Standing Committee that this could be built into the system of selection of PFMs. Upfront they will come with guarantee, we will obviously prefer PFM which provides an element of guarantee.”

Committee noted that major cause of concern for the employees is the fact that unlike the present pension system (which guarantees a monthly retirement income of 50% of the average of the last 10 months pay, devoid of any risk), the NPS leaves the likely retirement benefit of subscribers to be determined by the market. The Committee’s attempt to address this issue evoked the response that government was open to the idea of permitting/giving preference to such pension fund managers also who guarantee returns to operate in the market and that government is open to make available to the subscriber the option of 100% investment in government securities. Committee recommended that option of 100% investment of pension funds in government securities be made available and this aspect be indicated in clear terms in clause 20 (c) of the Bill.

On the projections of returns made to the Committee about higher returns than the return or the pension available under the current DB scheme, the Committee recommended that in the matter of selection of PFMs, preference be given to such companies which offer guarantees on returns. At the same time, it must be ensured that subscribers have sufficient options of choosing funds/schemes that may fetch high returns on the basis of market performance. Committee asked about the details of reported proposal to introduce the unorganised sector

workers bill which inter-alia includes issues relating to pension and Ministry of Finance replied in writing on the following lines:

“The Unorganised Sector Workers Bill is intended to be a comprehensive legislation to regulate the employment and conditions of service of unorganised sector and to provide for their safety, social security, health and welfare. As part of the comprehensive legislation, it has been proposed to frame a pension scheme for unorganized sector workers registered with the workers’ facilitation centre to provide for pension. It is further proposed that Central Government would also contribute at the rate of not exceeding 2.5% of the monthly wages of registered workers. This will go into a pension fund. Committee raised the issue of pension coverage of the unorganised sector workers as proposed in the Bill and MOF stated as under”.

The unorganised sector workers bill and the PFRDA Bill are complimentary and not contradictory to each other, Instead of having a separate pension scheme for unorganised sector workers, they could be accommodated under the NPS when its full architecture is in place. Going by the past experience of providing government funded old age pension to selected categories of senior citizens, the delivery mechanism has proven to be the single most bottleneck. The NPS and PFRDA will provide the backbone and infrastructure on which any such employee/employer/government funded initiative can be effectively implemented. As regards the coverage of unorganised sector, committee noted that NPS only offers an option to workforce to join. The committee desired that the government must bring forward comprehensive legislation in order to cater to social security of the unorganised sector inclusive of pension coverage of the work force simultaneous to the setting up of PFRDA as a statutory body.

Clause 23 (dealing with registration of certificate of pension funds):

Committee noted that provisions of clause 23 entitles the PFRDA to grant a certificate of registration to one or more pension funds for receiving contributions, accumulating them and making payments to the subscribers. The Committee recommend that the aspect that the government has decided for at least one pension fund would be from the public sector, be specified in clear terms in the clause as that would be in the interest of the subscribers.

Clause 24 (dealing with Registration of Intermediaries):

Committee questioned whether it is not essential to specify the pre-requisite for selection of intermediaries. Committee made specific reference to the financial and experience criteria for selection of PFMs and the FDI.

Ministry in the written reply elaborated as follows: “The requirements for qualifications of PFMs would be spelt out in the regulations. However, there is one difference in so far a capital requirement for insurers vis-à-vis PFMs are concerned. In case of insurers, pooled investment by insurers is done through the balance sheet of the companies. Whereas in case of PFMs, they would be managing the individual retirement accounts not through their own balance sheet, something like an asset management company, so capital requirement would be different (in case of PFMs) and need not be too much emphasized when registering the PFMs, PFRDA would keep this international experience in view that in the initial phases of development of the market, there would be place for only a finite number of players. As mentioned above, pre-requisites relating to capital structure, basic rules and regulations/ qualifications etc. will be provided in the regulations which will be subject to Parliamentary scrutiny”.

On the likely method of selection of PFMs, Ministry stated that there are two options either the eligibility criteria can be prescribed and any PFM which fulfils those criteria can be registered as PFM or they can be selected on the basis of bidding on costs and fees and technical qualifications. The mode of selection will be decided by PFRDA. International experience shows that even where there were a large number of PFMs, eventually, the number reduces due to consolidation. Representatives of confederations of trade and industry have opined that there should be sufficient clarity on the financial and experience criteria for PFMs. Committee opined that as in the case of insurance sector, the pre-requisite relating to capital structure and experience criteria for selection of PFMs need to be spelt out in clear terms in PFRDA Bill itself.

Committee also opined that criteria for selection of other intermediaries i.e. CRA etc. also need to be specified in the Bill. Committee noted that unlike the case of Insurance sector, the permissibility or otherwise of FDI in the pension sector – to

be promoted and regulator under the aegis of PFRDA – as well as limitations or restrictions on deployment of pension funds outside the country have not been specified. The Committee understands that government are yet to decide on the matter.

The Committee are of the considered opinion that any decision relating to permitting FDI in the pension sector should be implemented only by way of bringing forward suitable amendment in the present legislation. FDI and deployment of pension funds outside the country, should, in no way be in variance with the related provisions applicable to the insurance sector.

Clause 28 (dealing with attachment of assets and super-cession of management of intermediary):

Committee desired that clause 28 be suitably amended to enable the appointment of an Administrator in the event of exercise of powers under the clause for superseding the governing board/ management of the intermediary as no mention for such an appointment has been made in the clause.

Clause 47 (dealing with power to make regulations):

Committee noted that Authority's powers to make regulations encompass a very wide range of areas. PFRDA is modeled on the basis of IRDA. Committee has received suggestions that a similar committee (Advisory committee is available to the IRDA) or a board should be constituted for advising PFRDA on various matters.

Committee opined that the constitution of Advisory committee would be beneficial in enabling the Authority in making regulations. Committee noted that the Ministry has admitted that pension sector or pension market is in a very nascent state of development and firming up of regulatory aspects would be witnessed in course of time. Therefore, committee recommended that PF Advisory committee on the lines similar to that of IRDA may be set up with the representatives of employees and subscribers co-opted into it. This would enable safeguarding the interest of subscribers and discharging multifarious functions by the Authority.

Committee viewed that initial or broad contours of the regulations governing the implementation of NPS should be framed and made clear in the public domain prior to the enactment of PFRDA Bill.

Clause 50 (dealing with delegation of powers):

Committee notes that Authority is to constitute special committees to whom powers and functions of Authority could be delegated. With a view to protect the interests of the subscribers, Committee recommends that representatives of employees Associations and subscribers should be co-opted in the special committees to be set up by Authority.

Indian Pension Reforms – Current Realities

1. Background

India has one-sixth of the world population but India's share of world's elderly population is one-eighth. Indian population is relatively young because of high birth rate and high death rate. However, progressive improvement in mortality is changing this profile. In the inter-census period 1991 to 2001, population over age 60 has increased at annual rate of 4 percent as compared to annual growth rate of 2 per cent for population as a whole. The expectation of life at age 60 during this period has increased from 14.5 years to 17.5 years. The steady increase in longevity and declining birth rates will not afford old age income based on intergenerational transfers except possibly for the life time poor who need to be dependent on the State.

2. What Constitutes 'Pension Reforms'

2.1 It is necessary to emphasis here that "pension reforms" is a process and not an event. The reforms initiatives have to be pursued continuously with patience as the results may not be forthcoming over short to medium term horizon. While the expression 'pension reforms' has not been formally defined, it is generally accepted that the 'pension reforms' initiatives should lead to:

- a) increased coverage at adequate level for old age income;
- b) reduction/elimination of unfunded pension liability;
- c) Reduced role of the State as direct pension provider except for the Tier 1, the socially challenged and disadvantaged.

- d) Increased role of the State as facilitator in Regulatory mechanism for ensuring sustained development of variety of pension provision mechanisms.
- e) Regulatory mechanism to ensure security of the savings during accumulation period, adequate service and optimum returns to those who save for old age income through different vehicles;
- f) Availability of resources to the State for means tested tax financed pension when the reforms measures are successfully implemented.

2.2 'Pension reforms' is closely linked to political and socio-economic environment in a country and what has succeeded in one country may not necessarily succeed in another because of differing local environment. India is no exception.

3. Prerequisite for Reforms

If we look around for the lessons to be learnt from countries that have initiated pension reforms, one significant aspect that stands out as a part of the reform process is the need for a clear regulatory frame-work and a strong regulatory authority. In this context, initiating action on and achieving what has been mentioned in para 2.1 would require;

- a) suitable legislative framework
- b) strong regulatory authority for regulation and supervision of the different activities.
- c) Institution of "Ombudsman" for resolution of disputes, and
- d) Pension Protection Fund to protect rights in case of insolvencies of Pillar 2 Pension Funds, insolvencies of PFMs, Frauds and other risks.

4. Government Initiative on Legislation Front

4.1 The Government of India, on 1st January 2004, set up the Pension Fund Regulatory and Development Authority (PFRDA) by an executive order. The PFRDA Bill 2005 is envisaged to apply to:

- a) the New Pension System (NPS) ; and
- b) any other pension scheme not regulated by any other enactment

and would exclude from its purview:

- **all provident funds and Employee Pension Scheme 95;**
- **contracts referred to in sub-section 2(11) of the Insurance act 1938; and**
- **any other pension scheme which the Central Government may exempt from the application of the proposed PFRDA Act.**

In other words, the PFRDA would regulate and supervise the NPS and 'any other pension scheme not regulated by any other enactment' and the IRDA would continue to regulate and supervise pension products offered by life insurers.

4.2 The above in effect excludes the following areas where life insurance products currently do and have greater potential to add value;

- a) The Instruments under EPFO such as Employees' Deposit Linked Insurance
- b) The employees' Pension Scheme, 1995
- c) The Gratuity savings and risk cover products, whether under Payment of Gratuity Act, 1972 or under any other scheme
- d) The savings and risk products during accumulation and beyond under "approved Superannuation Funds"
- e) Individual Pension Products under specific provisions of the Income Tax Act.

5. Government Initiative on Operational Front

5.1 The Central Government employees joining service from 1st January 2004 have been given defined contribution pension with both the government and employees contributing 10 per cent of salary each. Currently, the contribution amount is being credited to public account of the government and interest @ 8 percent is credited on accumulation. After the PFRDA is established by an Act of Parliament and PFM are licensed, these funds would be allocated to the PFMs as chosen by the subscribers.

5.2 The NPS, designed to provide universal access, would be made available to public sector units and others and people from informal sector, simultaneously or in a phased manner. **However, the current focus being DC schemes as applicable to Central and State Government employees, it is arguable as when and how the NPS will get extended to voluntary subscribers!**

5.3 The reported initiative of the Government to establish Pension System for unorganized low income sector of the population independent of the NPS is likely to reduce PFRDA initiatives to DC system as applicable to Central Government and some State Government' employees.

6. Stake of the Life Insurance Industry in the current Pension Reforms initiatives

6.1 Opportunity to operate as PFM

6.2 Opportunity to be annuity provider

6.3 Opportunity to be part of Independent Retirement Advisor through its distribution system.

6.4 Opportunity to be part of POP network.

7. Current Stake of the Life Insurance Industry in the pension market not covered by any Pension reform initiative

7.1 All the sectors as described under 4.2 above wherein reforms are needed particularly;

- i Regulation of role of Trustees iro Gratuity and Superannuation Funds
- ii Regulation of Funding
- iii Regulation of actuarial management of these funds
- iv Review of tax incentives as these relate to the individual saver, the fund and taxation of the life insurer.

7.2 On 12th April 2006, the Union Finance Minister launched a micro-pension scheme designed by the UTI Mutual Fund for the members of Self Employed Women's Association (SEWA). Though not relevant for this segment, the scheme has been notified by Central Government in the Gazette Notification dated November 3, 2005 as a Pension Fund eligible under sub-section (2), clause (xiv) of section 80C of Income- tax Act, 1961 for assessment year 2006-07 and subsequent assessment years. **The Life Insurance industry is left out of this initiative and other potential areas.**

7.3 Currently there is no regulatory authority to regulate and supervise defined benefit retirement benefits such as pension and gratuity, except that the income tax authorities approving the schemes are envisaged to monitor that the schemes adhere to the prescribed investment pattern.

7.4 Unlike the impression and expectation of Life Insurance industry that the so called pension reform initiative will unfold hitherto unknown opportunities for role play, the reality is disappointing.

Accounting for Employee Benefits

India has been lagging behind in putting in place accounting Standards for Accounting for Employee Benefits for the financial statements of employers – It has recently announced its intention to converge to IFRS by Y 2011. The first Accounting Standard, AS 15 covering only retirement benefits came in to being in 1995 and the Indian Actuarial Profession followed it, in 1999 by putting in place a practice standard called Guidance Note 21. However in as much as the AS 15 was simplistic in its approach the Guidance Note by the actuarial Profession was ineffective in its scope as well as implementation.

Being under market pressure resulting from increasing globalisation of Indian economy, the Institute of Chartered accountants of India (ICAI) took up the revision of AS 15 and after considerable debate over some three years, came up with AS 15 (rev.2005) replacing AS 15 with intention to put it in to effect for

accounting periods commencing on or after 1 April 2006. Its scope extends beyond retirement benefits to cover all employee benefits (defined as all forms of deferred compensation given by an enterprise in exchange for service rendered by employees).

Opposition to it from Industry lobbies including Public Sector institutions such as Banks has put its implementation in back seat.

At the latest the ICAI announced, “

Deferment of Applicability of Accounting Standard (AS) 15, Employee benefits (revised 2005)
The Council of the Institute of Chartered Accountants of India (ICAI), at its 265th meeting held on February 3-4, 2007, decided to defer the date of applicability of Accounting Standard (AS) 15, Employee Benefits (revised 2005), issued by the ICAI, keeping in view the practical difficulties and general hardship being faced by industry. As per the decision, AS 15 comes into effect in respect of accounting periods commencing on or after December 7, 2006 (instead of April 1, 2006, as stated in the said Standard) and is mandatory in nature from that date. Earlier application of the Standard is encouraged.

In this context, a Survey by Watson Wyatt India of CFOs' views on, and preparedness for, AS 15 (rev.2005) brought out interesting results;

- 80 % of the respondents feel that AS 15 (R 2005) will improve the quality of financial reporting in India.
- 75% of the respondents expect that the need for actuarial services will increase.
- Broadly half of Indian companies seem unprepared to implement the new Standard.
- The biggest concern is that contributions can no longer be taken as cost; closely followed by apprehensions about volatility of reported cost from year to year.
- Only 16% of participants knew that Exempt Provident Funds are required to be treated as a defined benefit plan.
- Larger companies are better prepared than smaller ones.

The AS 15 (rev.2005) has significant financial reporting implications:

- All forms of employee benefits are now covered.
- In line with global practice the new Standard requires liabilities, and any assets, to be 'marked to market' – i.e. their value has to be consistent with current financial market conditions.

- Prescribed actuarial assumptions and method for assessment of (market consistent) liabilities.
- Immediate recognition of net benefit liabilities on the company's balance sheet.
- Significantly more onerous disclosure requirements.

The Survey further indicated that in spite of the concerns expressed, the majority of respondents believe that AS 15 (R 2005) is part of a trend towards harmonization of Indian accounting standards with global norms which will benefit Indian companies and investors. In fact, 80% of the respondents believe that AS 15 (R 2005) will improve the quality of financial reporting in India.

On the level of compliance with As 15, the Survey found 80% of participants responded positively to the question: "Does your company report retirement benefit costs under the existing AS 15?". However, clearly this still leaves 20% of companies who are apparently not following the existing AS 15.

Some participants are listed on overseas stock exchanges or are subsidiaries of foreign owned corporations. Thus 23% and 10% report employee benefits under and IAS 19 and FAS 87 respectively. These international accounting standards are closer to AS 15 (R 2005) than the existing AS 15 and so such internationally focused companies may be expected to be more prepared for India's new Standard.

On provision of variety of retirement and other employee benefits the survey found;

Benefit	% of participants providing the benefit	% not providing
Gratuity	96%	4%
Defined Benefit Superannuation	37%	63%
Leave Encashment	85%	15%
Post Retirement Medical/Healthcare	14%	86%
Long Term Service Award	14%	86%

On financing of these benefits the survey revealed a variety of different approaches;

(in percent)	Gratuity	Superannuation	Leave Encashment	Post Retirement Medical	Long service Award
No scheme	4	58	18	85	85
Unfunded scheme	27	8	64	11	12
Funded – Invested under Rule 67 of Income Tax Rules	10	4	4	1	0.5
Funded - Invested by LIC	47	24	7	1	2
Funded – Invested by Life Insurer other than LIC	6	3	2	0.5	0
Funded – Combination of any of the above approaches	2	1	1	0.5	0.5
Can't say	4	2	4	0.5	1

**Note – Totals may not sum to 100% due to rounding*

For those participants with gratuity and defined benefit superannuation plans we asked how both contributions (i.e. cash flow) and reported cost are determined. For close to half of employers providing gratuity, and 38% of employers providing defined benefit superannuation, these are calculated by the insurance company with which the fund is invested.

Under the existing AS 15 it is possible for contributions and reported cost to be the same and survey found that this is the strong preference of most companies: 63% of employers with a funded gratuity plan, and 78% of those with a DB superannuation plan, report a cost of retirement benefits in their P&L account which is equal to the cash contributions paid into the fund.

On the main concerns about AS 15 (rev.2005) the survey found;

- a) Volatility of reported cost from year-to-year on account of prescribed, market consistent, actuarial assumptions.
- b) Volatility of reported cost from year-to-year on account of showing the assets of a funded scheme at their fair market value in the company's financial statements.
- c) Impact on the company's Balance Sheet.
- d) Discount rate for calculating liabilities based purely on the yield on government securities even if a higher return is expected to be earned.
- e) Immediate recognition of volatile asset and liability changes in the company's P&L.
- f) Contributions (cash flow) to a funded scheme and reported cost can no longer be linked.

For each of the issues above, over 60% of participants were either 'concerned' or 'very concerned'. Participants with a high level of understanding of the new Standard were just as concerned as those with more limited knowledge. In the following chart a 'High' level of concern shows a participant is 'Highly Concerned' about the majority of these issues:

The concern most strongly voiced by participants was that the discount rate for calculating liabilities must in future be based purely on the yield on government securities. The second most commonly expressed concern was the need for immediate recognition of volatile asset and liability changes in the company's P&L. It is noteworthy that choice of discount rate and the implication for volatility of P+L cost are the two most actively discussed issues that in experience were discussed between employer and actuary under the old AS 15. The removal of any discretion on these issues under AS 15 (R 2005) is very likely to cause some headaches for CFOs, particularly in the first few years after initial implementation of the new Standard.

AS 15 (R 2005) requires an immediate adjustment to be made against the opening balance of revenue reserves and surplus for any shortfall in employee benefits liability provisioning as measured by the new Standard. Given that many banks have significant employee benefit liabilities, including defined benefit superannuation schemes, this may materially impact Tier 1 capital for capital adequacy purposes. Therefore, it is perhaps not surprising to find banks amongst the most well prepared participants for the implementation of the new Standard.

Insurance companies and unlisted companies with employees < 50 claimed to be amongst the least well prepared participants. This may be explained that as relatively new entities most private sector insurers still have relatively small employee benefits liabilities.

Acknowledgements

The two Survey Reports; on Retirement and Health provisioning and on Accounting Standard 15 (rev.2005) during the year 2006 published by Watson Wyatt Worldwide has been depended upon for information and views quoted in the paper.

Annexure 1

FUNCTIONS AND RESPONSIBILITIES OF PARTICIPANTS IN THE NEW PENSION SYSTEM

The new pension system will cover 2 categories of members:

- (a) The NPS is applicable to all the employees of the Central Government (excluding armed forces who have joined the service after 1st January 2004). In total 20% of the contribution (10% by the Government and 10% by the employee) are transferred to the individual pension account of the employee. Employees will have option to select PFMs and various schemes of investment under these PFMs. In addition, each employee will have option to voluntary contribute either in the same account or Tier-II account. In case of Tier-II account, employee will be free to deposit, withdraw from any POP location. The contribution amount and the periodicity will be decided by individual employee. However, government will not contribute to this account. In case of resignation by the government employee, his pension wealth as well as his Permanent Retirement Account (PRA) will not be affected. After resignation, the employee will not be eligible for 10% contribution from the government side.
- (b) Second category of members will include state government employers who decide to opt for NPS for their employees, employees of organization outside the purview of EPFO, employees excluded from the purview of EPFO, self-employed professionals, Non-Resident Indians, all informal sector workers, and all other citizens of India will be free to participate on a voluntary basis. These members will be allowed to maintain both Tier-I and Tier-II accounts with identical features and benefits which would be available to the Central Government employees. Members will be free to decide the amount and periodicity of contribution subject to some minimum investment, to be prescribed by the Authority, into their Tier-I accounts.

In both the categories of members and account types, unique account number will be allotted. All contributions will be credited to respective accounts. Members will have the option to select PFM as well as product. He

will be free to switch between PFMs and products. A consolidated account statement will be issued to the member showing up-to-date contribution to both the accounts.

Functions and responsibilities of Central Recordkeeping Agency (CRA):

Recordkeeping, administration and customer service functions for all members of the New Pension System will be centralized and performed by CRA. CRA will be directly responsible to the Pension Fund Regulatory and Development Authority(PFRDA) and members for the following functions:

1. Recordkeeping: CRA will be the single source of issuing the unique PRA to members. After issuance of PRA, CRA will be responsible for capturing and maintaining the personal details of members as well as the instructions issued by the members pertaining to choice of PFMs, various schemes etc. However, POPs and Pay & Accounts Officers(P&AOs), for government employees, will be responsible for the accuracy of data that they capture and transfer to the CRA which will be as per the contract between CRA and these entities. CRA will maintain this account till the retirement of the members and withdrawal of full terminal balance from PFMs.
2. Reconciliation: All instructions and information received from POPs and P&AOs will be reconciled by the CRA. On the basis of instructions received from members, funds will be allocated to the selected PFMs and schemes. CRA will be also responsible for accurately transferring the new contributions as well as speedy reconciliations of errors in this regard. CRA may receive a large number of documents, letters, requests, etc. in non-electronic form also. It will also be the responsibility of CRA to digitize them electronically and maintain record of all such information and documents.
3. Netting of instructions and fund transfer: CRA will be receiving contribution and number of instructions from members which will be consolidated and the net amount will be transferred to the PFMs on behalf of the members on daily basis. When a member retires and select an annuity provider the

CRA will withdraw funds from the relevant PFM and transfer the same to the selected annuity provider.

4. Customer Services: It will be the responsibility of CRA to provide members a periodic consolidated account statement after effecting instructions issued by the member during this period. Information pertaining to account balance, fees and charges etc. will be standardized by the PFRDA. CRA will also provide facility to its members to issue instructions and file complaints against POPs or for reporting errors in the statement through internet, telephone or a POP. CRA will also maintain a log of complaints lodged by the members.
5. Enforcement and compliance: the process of collection, transfer of contribution by POPs will be directly supervised by the CRA. CRA will take minimum action against irregularities and import penalty for delay/inaccurate transfer by POP. CRA will also be responsible to deduct tax at source for all withdrawals from Tier-I account. CRA will also be responsible for enforcing limits on members with regard to free switches prescribed by the Authority. It will be the responsibility of CRA to reconcile and debit asset management fees or charges for extra switches between schemes/PFMs.

Functions and responsibilities of PoPs:

The key factor of the NPS's success will be nation-wide low cost and efficient access to the NPS by the general public. Under the NPS, front-end service provider will be PoPs. It is expected that large banks, post offices, who are already providing financial services to the masses from the thousands of locations will be serving as PoPs. The ability of a PoP to accurately transfer information, instructions and funds to CRA will be of paramount importance for the success of NPS.

Various duties/responsibilities expected to be performed by PoP will be:

1. access to unbiased, accurate and complete system information on the NPS to potential members;

2. assisting individuals with opening Tier-I and Tier-II accounts, capturing and transferring individual contact and nominee information of each member to the CRA, issuing unique account numbers to members, and issuing and updating the PRA passbook;
3. collection and transfer of contributions and instructions regarding choice of PFM and scheme to the CRA;
4. account/identity verification and transmission of instructions regarding changes in PFM and/or scheme to the CRA;
5. facilitating withdrawals from Tier-II accounts,
6. collection and transfer of complaints from members to the CRA;
7. provision of performance information on PFMs/schemes to members on demand;
8. provision of periodic, consolidated account statements to members; and,
9. communication of verified changes in personal information of members to CRA.

Broad eligibility criteria for registration of entities as PoP will be based on ownership, capital, outreach capacity, existing regulatory oversight and ability to electronically transfer information and funds. PoPs will serve as a link between members and CRA and will be provided with a licence, interlinking format, and system specifications by the CRA. Regulatory entities such as SEBI, RBI and IRDA, departments nominated by the government, intermediaries with some experience in distribution of financial products and large employers participating in the NPS will be allowed to serve as PoPs. Similarly, for central and state government employees, the relevant P&AOs/DDOs managing the government's pay roll process will also perform some functions of PoPs. They will be responsible for:

- (a) Providing information pertaining to new employees joining service
- (b) Submitting information to open accounts for them
- (c) Deducting and transferring 10% employee's contribution as well as matching government contribution
- (d) Deduction and transferring contribution by the employee under Tier-II.

Autonomous bodies, non-civil ministries and government departments (Post, railways, telecom, etc.), and other state government bodies will be allowed to

nominate one nodal officer to perform these functions of PoP. Most of the informal sector employees are not used to modern finance mechanism including bank, postal branches etc. to channelise their savings. Because of low amount of contribution they will be very sensitive to the transaction cost. Micro-finance institutions like SEWA, BASIX, NGOs, workers' associations, unions and other self help groups which have credibility and access to this workforce can be registered as PoPs. They can also play an extremely useful role in the NPS to:

- a) Educate, inform, motivate and encourage their members to join the NPS and to regularly and adequately contribute to their retirement savings.
- b) Provide information to their members pertaining to investment schemes, their performance and other related information.
- c) Collect small value contribution of these members and transmit them to CRA as a lump sum amount on the behalf of their members.

Functions and responsibilities of Pension Fund Managers (PFMs)

The main function of PFMs will be to manage fund collected by the CRA by competing with various PFMs registered with PFRDA. Initially a limited number of PFMs will be allowed to compete and perform the specialized function and managing the investments of the members. Everyday CRA will be receiving payment and instructions regarding:

- a) New contribution to PFMs and schemes.
- b) Switches among PFMs/schemes
- c) Terminal withdrawals

After consolidating and reconciliation of all such instructions and funds received from members through POPs a net amount will be transferred to the PFMs. This single amount will be transferred alongwith the statement specifying the exact amount to be invested in the various schemes of that particular fund manger. PFRDA will issue investment guidelines for allocation of these assets under each scheme which will have to be compiled by the PFMs. Only firms with prescribed

fund management experience and specified eligibility criteria to be prescribed by PFRDA will be eligible to apply for a PFM licence.

Functions of Authorised Retirement Advisors (ARAs)

Sales and marketing activities under the NPS will be performed by ARAs. ARAs will deliver advisory services to the potential members regarding PFMs as well as various schemes offered by them. They will also advise and assist new members to open the retirement account as well as in selecting appropriate investment scheme which is more suitable to them. ARAs will have to follow a uniform code of conduct and ethics. They will have to pass an examination to be prescribed by the PFRDA. ARAs will be affiliated either to a specific PFM, POP or may work as an independent advisor to provide services to the members. Existing agents/distributors of mutual funds, insurance firms, will also be allowed to work as ARAs on the basis of norms to be prescribed by the PFRDA. The Transaction forms filed by the members and deposited through an ARA will bear his certification number on the basis of which CRA will track the volume of transactions by that ARA and fees/charges payable to the ARA.

Functions of Annuity Providers:

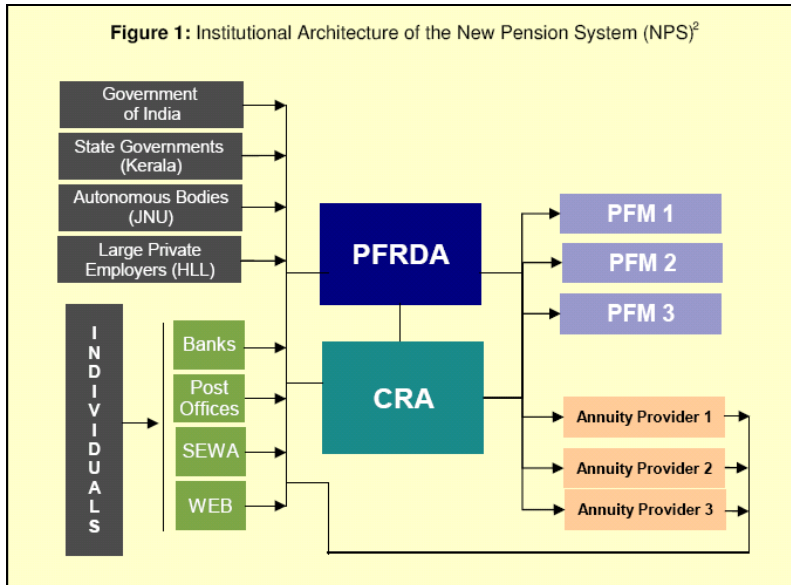
As per the NPS when a member retires he will have to use a specified percentage of his pension accumulation in his PRA to buy an annuity from a pool of competing annuity providers. Annuity provider will be responsible for delivering a regular monthly pension to the members during the rest of his life. Life insurance companies registered with Insurance Regulatory and Development Authority (IRDA) will be authorized to serve as annuity providers to the members of NPS. Retirement age of non-government employees and employees of unorganized sector will be decided by the PFRDA. Only after attaining this age members will be allowed to withdraw their savings and buy an annuity.

The process of delivery of pensions to the members will be regulated by the IRDA since annuity will be provided to the members by the life insurance companies registered with IRDA. However, if a member selects not to withdraw lump sum part of his savings, and decides, instead, to phase out his withdrawals

from his PRA, he will be allowed to do as such. In that case, he will continue to interact with service providers under PFRDA system.

Annexure 2

The institutional architecture of the New Pension System:



About the Author

Liyaquat Khan a Fellow of Institute of Actuaries, London and of Actuarial Society of India (recently renamed as the Institute of Actuaries of India) has had experience in Insurance Industry and has occupied many professional positions. In particular;

- 1) Was President of Actuarial Society of India for the Y 2000-2001 and Y 2002 to 2005.
- 2) Served on the governing council of the International Actuarial Association for as many years and has served on its Employee Benefits Committee.
- 3) Currently, Liyaquat is Executive Committee member of the International Association of Consulting Actuaries (IACA).
- 4) Liyaquat is current Chairperson of the Health Insurance Committee of the Institute of Actuaries of India.
- 5) Liyaquat is also associated with the recently formed Actuarial Association of Bangladesh and Chairs its Education & Examinations Sub-Committee.
- 6) Liyaquat has served as CEO of two Life Insurance companies, in India and Sultanate of Oman and also as Vice-Chairman & Chief Actuary of Watson Wyatt India for some three years before moving over to HSBC group in Jan 2007 as Head – HSBC (Global Actuarial Function), located in Kolkata, India.
- 7) Internationally, besides serving as CEO of a life insurance company in Sultanate of Oman, Liyaquat has served as Actuary and Financial Advisor to SICOM Ltd, Mauritius and was Actuary to National Pension Scheme of the Government of Mauritius.
- 8) Liyaquat has been involved with the Indian Insurance regulator, IRDA and served as member of its Insurance Advisory Committee from Y 2000 till Y 2005 and was a member of K P Narasimhan Committee to review the Indian Insurance Act, 1938 in the year 20004-2005.

Liyaquat has keen interest in development of Actuarial Profession globally and can be reached at Actuary_khan@sify.com