

Pension and Other Retirement Benefits – A view on India

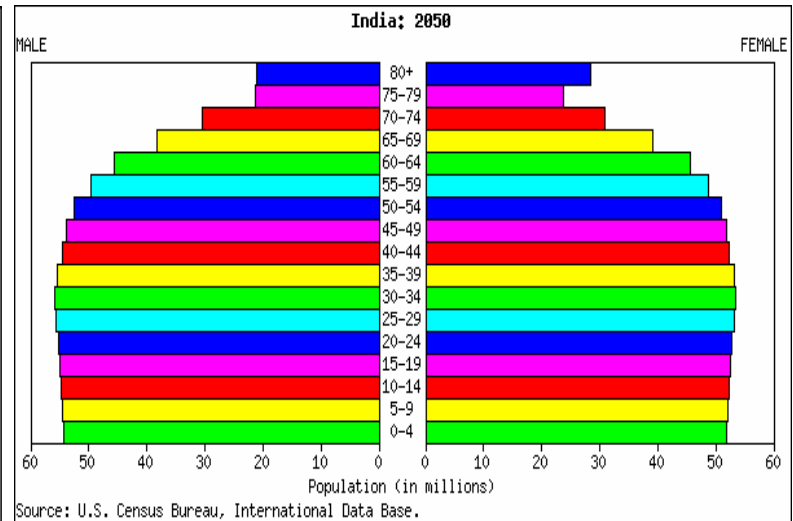
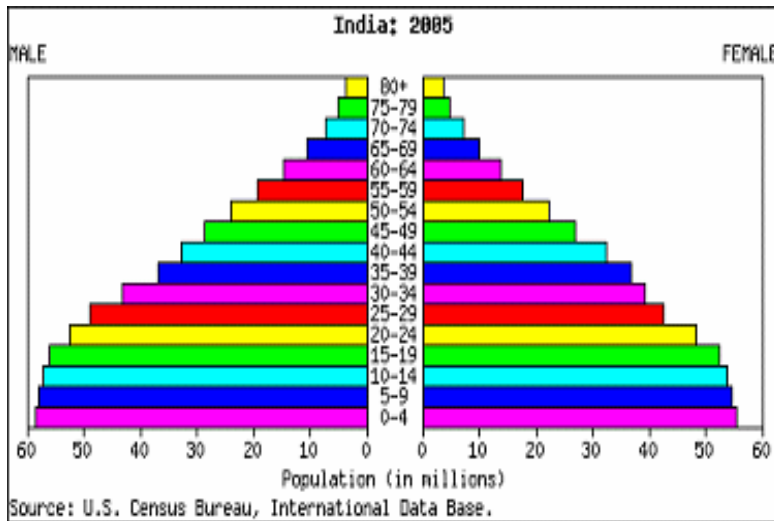
14th East Asian Actuarial Conference
9-12, October 2007
Tokyo

Presentation by
Liyaquat Khan, FIA; FASI; FASB
India

AGENDA

- Indian Demographics
- What Corporate Sector feels;
 - Impact of Demographic Changes
 - Retirements Benefits issues
- Indian Pension “Reforms” – Passages;
 - Passage 1: Pre-March 2005
 - Passage 2: PFRDA Bill 2005
- Indian Pension Reforms – Current realities;
 - What should constitute Pension Reform?
 - Pre-requisite for reforms
- Government Initiatives
- Life Insurance Industry and Pension Reforms
- Corporate and Retirement Benefits
- Accounting for Financial statements
- So what’s the view?

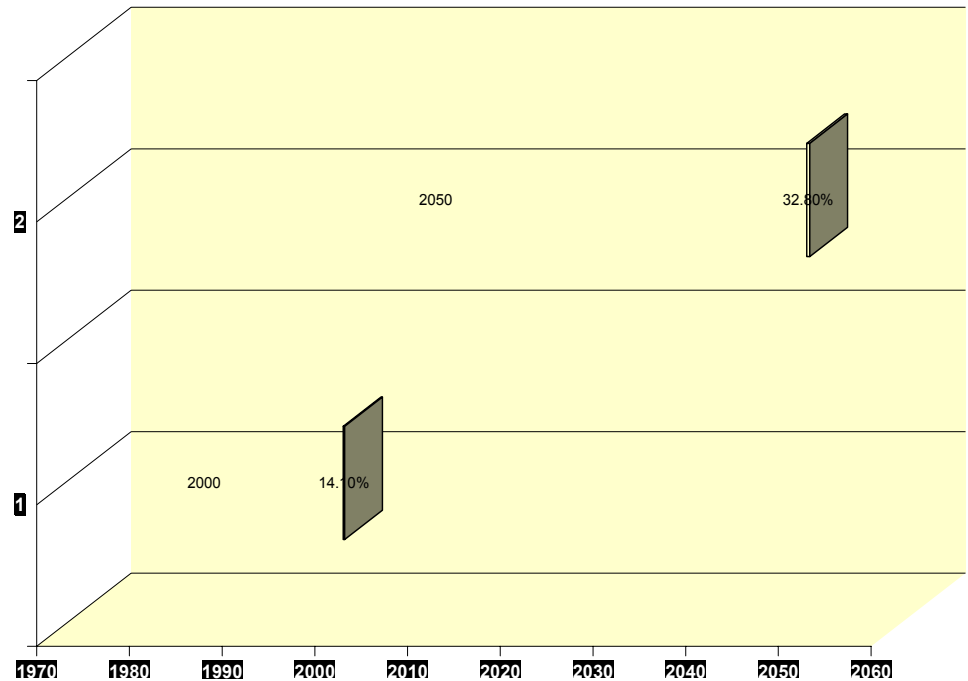
A – Indian Demographics



A – Indian Demographic

Population \geq 50 years

Y 2000	Y 2050
14.10%	32.80%
141 million	500 million



.....A – Indian Demographics

As a result and in the back drop of continually growing Indian economy;

- a) Employers will have a need to hire older workers and to keep them longer in employment.
- b) The Healthcare and Retirement benefits are anticipated to occupy the centre stage of Corporate HR Policy and Practice.
- c) Major HR challenge will be not as much in recruiting (which is as of now) but in much greater hurdle level of talent retention.

.....A – Indian Demographics

The current realities;

- a) Income from statutory retirement benefits are inadequate to maintain even a basic standard of living,
- b) Public Healthcare services are inadequate and inefficient to meet basic healthcare needs,
- c) The perceived “Pension Reforms” initiative in 1998 has turned out to be misdirected and that too a non-starter,
- d) There are no initiatives on public health services.

.....A – Indian Demographics

Opportunities for Corporate Sector;

- a) To be innovative in HR policies so as to retain and even recruit at much higher ages than now,
- b) Immense opportunities to play key roles for Retirement & Health Solution providers & stakeholders such as;
 - Insurers
 - Consultants
 - Intermediaries



B - What Corporate Sector feels

On Impact of Demographic changes;

- a) **Employers think** employees' appreciation of Healthcare (73%) and Retirement benefits (65%) will increase over the next 15-20 years
- b) To address the Demographic changes over the next 5-10 years companies are in the process of introducing new retirement benefits (73%), healthcare (74%) and post-retirement healthcare (65%). About 65% of the **employers think** employees need to share the cost.
- c) **Employers think** that, the government should:
 - Legislate (56%)
 - Provide tax incentives (55%)

.....B - What Corporate Sector feels

On Retirement benefits issues;

- a) Although **56% of the employers are of the view** that the company has an obligation to help employees save, **55% of them think** the employees should bear all the investment return risk.
- b) **67% of the employers claim** that their companies provide supplementary retirement benefits. However, some employers believe that their retirement benefits help to attract (48%) and retain (43%) high-performing employees.
- c) 50% of retirement benefits schemes are DB, while DC and Hybrid Retirement Benefits account for 33% and 17%, respectively.
- d) 51% of companies are taking actions to change their current schemes to a DC scheme.



C - Indian Pension “Reforms” – Passages;

Passage 1: Pre-March 2005;

OASIS Phase 1 -

- a) In **1998**, the Government, constituted a Committee (Project OASIS) with 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 type Social Security arrangements.**

- b) **On 01 02 1999** the OASIS Committee submitted its **Phase - 1** report covering **existing** mechanism for Social Security as well:
 - Provident Funds,
 - Pension Schemes, and
 - Public Provident Funds.

...C - Indian Pension “Reforms” – Passages; Passage 1: OASIS Phase 1-

Its important to note:

- When this Report came out (Feb. 1999), the Insurance Sector was not opened to Private Sector participation.
- The only Life Insurer then – LIC was selling annuity products but for variety of reasons, these products were rarely sold.
- The only connect with life insurance that this report dealt with was provision of annuities.
- The report created controversies leading to debate in various sections including the Employees’ Provident Fund Organisation (EPFO) and the controlling Ministry – Labour, taking a position that the OASIS Committee had no jurisdiction to comment on PF systems.

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, non-existence of Ombudsman and benefit protection mechanism.

.....C - Indian Pension “Reforms” – Passages; Passage 1: OASIS Phase 2-

On 11 01 2000 the Phase II (final) report was submitted 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.”

...C - Indian Pension “Reforms” – Passages; Passage 1: OASIS Phase 2-

The 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.
- 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.
- 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) In respect of Annuity Providers it recommended , “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.”

...C - Indian Pension “Reforms” – Passages; Passage 1: OASIS Phase 2-

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....

As it turned out latter only the above become point of focus by the government!

.....C - Indian Pension “Reforms” – Passages; Passage 1: OASIS Phase 2-

- The Report became the basis for the PFRDA Bill, 2005 (21 03 2005) with focus only on the Contributory Pension Scheme for Central Government employees.
- The Central Government picked the above recommendation to stop the DB scheme for all new hires effective 01 01 2004.
- 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 it's key point of activity.
- **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.**

.....C - Indian Pension “Reforms” – Passages; Passage 1: The IRDA report (Nov. 2001)

- While the debate amongst various stakeholders was going on the OASIS Report, the Minister of Finance in Budget speech in Feb. 2001 announced the appointment of another Committee to be constituted by the 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 unorganised sector and capable of absorbing all others who want to participate in it.”**
- Details apart, it recommended a pension system i e DC like the one recommended by OASIS Committee, however on the question of Annuity providers and regulatory matters it suggested;
 - a) “Paying of the annuity to the subscriber contributor will have to be exclusively handled by a life insurance company.”
 - b) “.....the regulation of the pension sector could be handled by the IRDA.

.....C - Indian Pension “Reforms” – Passages; Passage 2: The Pension Fund Regulatory and Development Authority Bill, 2005 (PFRDA Bill 2005)

Taking the matter forward from OASIS the Government proposed a “new pension system” **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.

The PFRDA Bill though had scope wider than covering only government employees, the focus of the government was evident.



D - Indian Pension Reforms – Current realities; What should constitute Pension Reform?

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 Pillar 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,
- f) Availability of resources to the State for means tested tax financed pension.

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.

Unfortunately nothing has happened and does not appear to be happening on the above lines!

...D - Indian Pension Reforms – Current realities; Pre-requisite for reforms?

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 under “what should constitute pension reform” 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.



E - Government Initiatives

Initiative on Legislative front:

The Government of India, on 1st January 2004, set up the PFRDA by an executive order. The PFRDA Bill 2005 is envisaged to apply to:

- the New Pension System (NPS) ; and
- 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.

.....E - Government Initiatives

The above initiative excludes the following areas of interest of life insurers;

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

.....E - Government Initiatives

Initiative on Operational Front

- The Central Government employees joining service from 1st January 2004 have been given DC Scheme. After the PFRDA Bill becomes an Act and PFMs are licensed, these funds would be allocated to the PFMs.
- 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!**
- 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 beyond what is applicable to Central Government and some State Government' employees.



F - Life Insurance Industry and Pension Reforms

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

- Opportunity to operate as PFM
- Opportunity to be annuity provider
- Opportunity to be part of Independent Retirement Advisor through its distribution system.
- Opportunity to be part of POP network.

.....F - Life Insurance Industry and Pension Reforms

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

- All the sectors described earlier wherein reforms are needed,
- Regulation of role of Trustees iro Gratuity and Superannuation Funds
- Regulation of Funding
- Regulation of actuarial management of these funds
- Review of tax incentives as these relate to the individual saver, the fund and taxation of the life insurer.

.....F - Life Insurance Industry and Pension Reforms

The reality!

- a) 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.
- b) 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.



G – Corporate sector and Retirement Benefits:
On provision of variety of retirement and other employee benefits

Benefit	% of participants providing the	% 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%



H - Accounting for Financial statements

- 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 also in implementation.

.....H - Accounting for Financial statements

- 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. It's scope extends beyond retirement benefits to cover all employee benefits.
- Opposition to it from Industry lobbies including Public Sector institutions such as Banks has put its implementation in back seat.
- Now. 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

.....H - Accounting for Financial statements

A view on AS 15 (rev.2005) by Corporate sector;

- 80 % feel that AS 15 (R 2005) will improve the quality of financial reporting in India.
- 75% 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% knew that Exempt Provident Funds are required to be treated as a defined benefit plan.
- Larger companies are better prepared than smaller ones.

.....H - Accounting for Financial statements

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.

.....H - Accounting for Financial statements

The majority of the employers 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% believe that AS 15 (rev. 2005) will improve the quality of financial reporting in India.



I – So what's the view?

- Pension reforms: same as in 1998?
- Framework for Life Insurers' opportunities: same as when the Sector opened in Y 2000?
- Financial reporting standards: some progress?





Thank YOU for your attention!

And be in touch

Actuary_khan@sify.com