Saving for retirement – the role of NPS

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Presented at the FICCI-PFRDA session on National Pension System (NPS)

8 March 2018
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Brief background on pension systems
Pension systems

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

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

- where performance has two phases:
  1. Funds accumulation phase and
  2. Pensions payout phase.
Issues in pensions policy

Three points of policy focus in performance:

1. Investment policy:
   - Deliver high performance at low costs
     This must hold in both the *accumulation* and the *payout* phase (wherever payout is not a one-time, lumpsum event).
   - The more sophisticated the investment policy, the more governance oversight required.

2. Governance of pension fund management:
   - Managerial control of the organisations.
   - Minimise conflict of interest between those who manage the funds, and fund members.

3. Access and delivery of the pension system
   - Particularly if it has to offer a successful old age security feature for the informal workforce.
The NPS initiative
Where does NPS fit?

- NPS was born in the context of
  - the global pension reforms process and
  - recognising India’s large informal sector workforce, and
  - an exploding pension demand on the Indian fisc.
    - Defined benefit, EPS – mandatory, unfunded.
    - Defined contribution, EPF – mandatory, funding unknown
    - Exempt funds, private PF funds
    - Defined benefit, government pensions.
The NPS 1999 vision

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

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

Several breaks with design principles:

1. Enable choice between NPS and EPFO – not fully implemented
   Lumpsum withdrawals under NPS is taxed, not under EPFO.

2. Accumulation returns – departure from indexation in investment $\rightarrow$ higher cost, lower returns.

3. Accumulation returns – partial withdrawal allowed in Budget 2017 $\rightarrow$ lower returns

Other challenges in implementation

▶ Policy change needs time to set in.
   Too early to comment on problems based on end performance?

▶ Deeper problem with frequent policy interventions – makes it difficult to understand if the policy is working or not.

▶ Wide coverage objective yet to be achieved.
   Total civil workforce = 474 million (NSS, 2011-12)
   Covered workforce = 58 million (from Economic Survey and EPFO estimates, 2011-2012)

▶ But resultant interventions have not helped.
   ▶ Example: NPS-Lite replaced by APY → confusion among the target audience.
   ▶ Example: incentivising distribution → relapse into the regime of higher probability of mis-selling and lower customer protection.

▶ No focus on developing a competitive, well-functioning market for annuities.
NPS remains a potentially great long term savings product. *In search of inclusion: informal sector participation in a voluntary, defined contribution pension system* by Sane and Thomas, 2015

Documents that low-income households contribute to NPS and contribute regularly.

Ideally, coverage has to be higher.

Indian savings is skewed into non-financial assets. *The Indian household finance landscape* by Badarinza, Balasubramaniam and Ramadorai, 2016.

Frequent interventions make it troublesome to evaluate impact and confuse the target audience.

More policy discussion and careful design (linked to stated and observed outcomes) is needed.

This can help achieve the end goal of pension systems.
Thanks

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