

SEMINAR ON PENSION REFORMS – BOMBAY CHAMBER OF COMMERCE AND INDUSTRY ON 18.1.2008.

It gives me great pleasure to be here amongst you at the invitation of the Bombay Chamber of Commerce and Industry. This meeting provides a wonderful opportunity to have interactive discussion with knowledgeable people on pension reforms.

I propose to provide a brief back-drop on pension reforms, the developments so far and the issues involved in the time to come. At the end, I would welcome, in fact encourage, questions from you all.

As all of you know, India's need for pension reforms arises from demographical trends, low coverage of the existing old age security programmes and the Government's fiscal constraints.

It may come as a surprise to some of you that India is perhaps the youngest country in the World today with an average age being only 26 years. The dependency ratio in India is also one of the lowest in the World. The policy imperative of this demographical situation is that this is a right time to introduce pension reforms and establish a solid and sustainable social security arrangement in the country. I may also mention that India is growing old at a very fast rate and the population of people above 60 years of age, which is 80 million today, would double in the next 18 to 20 years. Therefore, any delay in implementation of pension reforms will hit hard the reform process and nullify the advantages which we have today.

As for existing coverage of old age reforms system, only about 12-13 per cent of the total workforce is today covered by any formal social security system. The remaining 87 per cent do not have access to any formal scheme for accumulating wealth to sustain them after retirement. NPS is primarily meant for this 87 per cent of the workforce.

The pension budget of the Central Government and the State Governments is something like Rs. 65,000 crore per year. It is growing at an alarming rate of over 20 per cent per annum. Sooner than later, this burden on Government finances will become unsustainable. It is this consideration which compelled the Central Government to ring-fence this liability and introduce defined contributory system for the new employees. Similar action has been taken by nineteen other State Governments so far. The expectation is

that the remaining State Governments, other than West Bengal, Tripura and Kerala, will also opt for DC based NPS.

All this has taken nearly 10 years to conceptualize, discuss and debate policy parameters, devise a simple NPS architecture after detailed practical studies. We have now reached the stage of take-off. I believe all present here would already be aware that we have appointed a Central Recordkeeping Agency and three Fund Managers to operationalise NPS. CRA has been given 24 weeks to put in place an elaborate infrastructure to provide a solid and efficient foundation for NPS. It is expected that before 31st May, 2008, CRA will be fully functional. Meanwhile, the three fund managers have incorporated new companies and are expected to start work by 31st March, 2008. Before the end of the current financial year, PFRDA would also be establishing a NPS Trust and also appointing a Custodian Bank as also an entity for custodial services. We are hopeful that the NPS contributions of the employees of the Central Government and 19 State Governments would be transferred to these fund managers by the respective Governments in the beginning of the next financial year.

Let me refresh your memory regarding the broad features of the NPS. NPS provides seamless portability across jobs and across locations, unlike all current pension plans, including that of the EPFO. In other words, it would provide hassle-free arrangement for the individual participants. It is a pure DC product with no defined benefit element, returns being totally market-related. NPS will also provide various investment options and choices to individuals to switch over from one investment option to another or from one fund manager to another subject, of course, to certain regulatory restrictions. At this point of time, however, there shall be only two investment choices – investment of entire contribution in Government securities alone or adopting the investment guidelines applicable to non-government provident funds. The current government guidelines provide that upto 15% can be invested in equities and the balance 85% in fixed income instruments. Once the PFRDA Bill is passed by Parliament, the Regulator will provide more investment choices which will allow investment of upto 50% of the pension wealth in equities. In the initial years, it is proposed to restrict investments through index funds and ETFs. In the United States, equity holding of pension funds is as high as 70%. Even in Peru and Chile major part of pension money is invested in shares of companies with lower concentration in public debt securities. It may take perhaps some time in India to reach this

level but let me assure you that we would move in that direction. Another feature of NPS will be comparatively lower costs.

Through a process of competitive bidding, we have discovered an investment management fee of 3 and 5 basis points and transaction costs of upto 10 basis points. Once the volumes increase, these costs can only move southwards. Low costs will enhance pension wealth and bring in more customers.

We face several challenges in the development of this sector. The main challenges, to my mind, are to provide safety and high returns, extending coverage to as many people as possible and to improve financial literacy levels. Only yesterday, Economic Times, referring to a saving survey conducted by AVIVA group, brought out the level of financial illiteracy in metro towns like Kolkata, Delhi and even Mumbai. All stakeholders in pension reforms will have to make special efforts to educate potential participants about benefits and advantages of saving for retirement. I may, however, mention that this attempt to educate the people should not be in the form of sales and marketing efforts by the fund managers.

Some of you may be interested to know if any estimate has been made about the progressive growth of assets under management. An assessment made by a FICCI-KPMG study shows that the AUM will be USD 95 billion in less than 20 years. Another study done by an expert group set up by the Government indicates a slightly higher estimate of USD 100 billion.

One important element which would greatly incentivise pension savings is the tax treatment given to it. At present, NPS is subject to the EET tax regime. On the other hand, EPF, GPF and PPF have more favourable tax treatment. EEE benefit is available to them. This goes against the basic philosophy of encouraging contractual savings, which provide long-term funds for investment. We have taken up this issue with the Government and I am hopeful that this will receive favourable consideration.

PFRDA is tasked with the responsibility of developing a healthy pension sector. We are taking this mandate very seriously. I very often mention that unless the sector develops, there will be nothing for PFRDA to regulate. In this effort, I seek your active cooperation so that India has a sound, robust and efficient system of retirement savings.