

## Role of Financial Planning Services in the Pension Sector Mumbai 1<sup>st</sup> February 2008

### **INTRODUCTION**

Good Morning Ladies and Gentlemen. It gives me great pleasure to be here this morning on the occasion of the Annual Financial Planning Convention and the Convocation Ceremony. I wish to congratulate all those who will today receive the coveted Certificates of having successfully completed the CFP program and stand poised to begin their professional career as certified financial planners. It is an interesting and exciting area of work and also a 'satisfying' vocation in the sense that you will be sub-serving the social objective of advising people on personal finance.

2. I will today share with you the developments in the process of implementation of the New Pension System and the important role that could be played by the young and budding financial planners in providing invaluable inputs for the success of this major reform initiative of the Government. Firstly, I would like to share with you, in brief, the background under which the NPS was introduced and then take you through the various stages of the journey of implementation of the NPS architecture so far.

### **BACKGROUND**

3. 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.

4. It may come as a surprise to some of you that India is perhaps the youngest country in the World today with the 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, however, 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.

5. 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.

6. 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.

## **NPS ARCHITECTURE**

7. It has taken nearly 10 years to conceptualize, discuss and debate policy parameters and to devise a simple NPS architecture after detailed practical studies. Although we have drawn upon the experience of other countries, I can say with confidence that the NPS architecture consisting of a Central Recordkeeping Agency (CRA) and Multiple pension fund managers along with the NPS trust, custodian, Retirement Advisers and other players that we have devised is unique. We have studied the systems prevalent in Chile, Mexico, United Kingdom, USA and Australia amongst others, but have devised a system that meets Indian conditions and needs. We have tried to learn from the mistakes that some countries had made and attempted to **design** an architecture which is simple, cost effective and robust.

8. The most distinguishing feature of NPS relates to 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. However, to begin with 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 allow only prudential norms for investment guidelines but let me assure you that we would move in that direction. Another feature of NPS will be comparatively lower costs.

9. PFRDA has appointed, through a process of competitive bidding, State Bank of India (SBI), UTI Asset Management Company (UTI-AMC) and Life Insurance Corporation (LIC) as Pension Fund sponsors under the NPS. They have already incorporated their Pension Funds as new companies under the Companies Act, 1956 and are expected to start work by shortly. Through this process of competitive bidding, we have discovered an investment management fee of 3 to 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. Once the volumes increase, these costs can only move southwards. Low costs will enhance pension wealth and bring in more customers.

### **ROLE OF FINANCIAL PLANNERS**

10. We face several challenges in the development of this sector. The main challenges, to my mind, are to empower the subscribers to take appropriate investment decisions based on their risk and return profile, provide safety and high returns, extending coverage to as many people as possible and to improve financial literacy levels. All stakeholders in pension reforms will have to make extra efforts to educate potential participants about benefits and advantages of saving for retirement. Here the role of financial planners is crucial and of great significance.

11. The NPS architecture is designed in such manner that the subscribers will have no direct link with the pension fund managers. Therefore, the exercise of choice in respect of fund managers and investment styles has to be made by subscribers. Given the level of financial education in the country, this responsibility will devolve on the shoulders of experts like you. It is expected that there would be an important role for financial planners as they could provide this service to subscribers. The PFRDA Bill also envisages role of retirement advisors in the NPS architecture. The retirement advisors will enable individual subscribers to plan for their retirement income which is adequate and also help in making the right kind of investment choice that meets her objectives. This is one of the roles that could be successfully played by the certified financial planners.

12. The other important role for the financial planners could be their role vis-à-vis pension fund managers. I believe the certified financial planners will have good understanding of the management of funds that is expected under the pension sector- with longer investment horizons and with optimum returns and low risk. Here they could provide advisory services to the pension fund managers so that their performance is in congruence with the needs of the individual subscribers.

13. In order to enable the financial planners to provide the envisaged services, the Financial Planning Standard Board could prescribe certification programmes after due approval of the PFRDA. The detailed curriculum of the courses could be discussed with PFRDA and a benchmark for the required levels of skills may be set in respect of the financial planners who could provide advisory services to subscribers and pension fund managers.

## CONCLUSION

14. I would like to conclude by saying that although the NPS architecture for Government employees is expected to start functioning from 1<sup>st</sup> of June 2008 the real challenge will be in seeing that the system functions smoothly. In this regard, the issues relating to safety and high returns, extending coverage to as many people as possible and improving financial literacy levels would be of paramount importance. All stakeholders in pension reforms including financial planners will have to make special efforts to educate and advice potential participants about benefits and advantages of NPS. Each one of us present here has a responsibility to discharge in this respect. We have to create a certain level of financial literacy and awareness amongst the NPS subscribers which will eventually empower each subscriber to make well informed investment choices to protect and further their own interests.

15. Government employees, who are today the sole participants in the NPS, will be able to reap the full benefits of the system once it is made available to the wider target group of the unorganised sector workers. It is only when the system is made available to all citizens that it's full potential will be realized in terms of economies of scale and the subscribers will gain substantially in terms of even lower fees and charges and high returns.

16. PFRDA is tasked with the onerous responsibility of developing a efficient and modern pension sector. We are taking this mandate very seriously. I would like to repeat what I generally mention in most of the forums that unless the pension sector develops, there will be nothing for PFRDA to regulate. In this endeavour, I call for your active participation so that the country has a sound, robust and efficient system of retirement savings.

17. Let me once again thank FPSB to have invited me on this special occasion to interact with all of you. My best wishes to your noble profession and, especially, to those who will today receive certificates as CFPs.

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