

**WORKSHOP ON STATE LEVEL CAPACITY BUILDING FOR PENSION  
REFORMS  
NIPFP -22 JANUARY 2008**

***INTRODUCTION***

A very good morning to all present. It gives me great pleasure to be here this morning and to be sharing with you the developments in the process of implementation of the New Pension System or the NPS as it is commonly known. I would like to share with you, briefly, 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**

2. 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.

3. 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.

4. 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.

### **NPS ARCHITECTURE**

5. 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, and other players that we have devised is unique. We have studied the systems prevalent in Chile, Peru, 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 devise an architecture which is simple, cost effective and robust.

6. I believe all present here would already be aware that during the conference of Chief Ministers held under the chairmanship of the Prime Minister in New Delhi on 22<sup>nd</sup> January 2007, a consensus had been reached that implementation of the NPS architecture cannot be put off any further and that the pension accumulations of Government employees hitherto lying idle in the Public accounts of the concerned Governments should be moved to professional pension fund managers for investment purposes. As a follow up on the decisions taken at this conference, PFRDA has appointed a CRA and three Fund Managers to operationalise NPS.

### **CENTRAL RECORDERKEEPING AGENCY**

7. Within the mandate given to us of engaging only public sector entities as CRA and Fund Managers, PFRDA has attempted to adopt a transparent and competitive process of selection of these entities. The selection of NSDL as the CRA and SBI, UTI AMC and LIC as fund managers was an outcome of a two stage competitive bidding process in which technical competence of the bidders, their past track, etc and the fees and charges quoted by them have been given due weightage. This competition has resulted in low fees and charges.

8. The CRA is a first of its kind venture in India and is critical to the successful operationalization of the NPS. The main functions and responsibilities of the CRA shall include:

(i) Recordkeeping, Administration and customer service functions for all subscribers of the NPS.

(ii) Issue of unique Permanent Retirement Account Number (PRAN) to each subscriber, maintaining a database of all PRANs issued and recording transactions relating to each subscriber's PRAN.

(iii) Acting as an operational interface between PFRDA and other NPS intermediaries such as Pension Funds, Annuity Service Providers, Trustee Bank etc.

9. An important feature of PRAN to be issued by CRA is that it shall be portable across jobs and geographical locations. As per the agreement entered into between PFRDA and NSDL, the building up of CRA operations shall be completed within 24 weeks. Accordingly, CRA operations are expected to commence in respect of Central Government employees latest by 1<sup>st</sup> June, 2008. As you are aware, it is open to State Governments and Union Territories to participate in this CRA facility. You can thus open a dialogue with NSDL right away and work out the details for your State within the overall architecture of NPS and the terms and conditions agreed to by NSDL while signing a contract with PFRDA.

10. In terms of the agreement, NSDL shall be charging a volume driven and highly competitive fee for rendering CRA services to the subscribers of the NPS. The Annual Maintenance Charges and Transaction Charges payable per subscriber shall be Rs. 350 and Rs. 10 respectively (till such time as the number of accounts with the CRA reaches ten lakh); Rs. 280 and Rs. 6 respectively (on the threshold limit of ten lakh accounts being reached) and Rs. 250 and Rs. 4 respectively once the number of accounts with the CRA reaches thirty lakh. In addition, NSDL shall be charging a fee of Rs. 50 per account as account opening charges.

### **PENSION FUND MANAGERS**

11. PFRDA have also 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 31<sup>st</sup> March, 2008. The three pension funds will be performing the investment management functions under the NPS for a fee varying from three to five basis points. In addition, they will be entitled to reimbursement of brokerage fee 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.

12. PFRDA is currently engaged in the process of registration of the NPS Trust and appointment of a Custodian and a Trustee bank. It is expected that by 31<sup>st</sup> May 2008 the entire NPS architecture will be in place in respect of Government employees. This system can be scaled up without any problem the moment the NPS is made available to other citizens of India. 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.

### **INVESTMENT OPTIONS**

13. For convenience, let me repeat the broad features of NPS. NPS provides seamless portability across jobs and across locations. In other words, it would provide hassle-free arrangement for the individual participants. 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.

## **OTHER RELATED DEVELOPMENTS**

14. It may not be out of place to mention developments in certain areas related to NPS which I believe will influence the acceptability of NPS and its growth thereafter.

14.1 We at PFRDA have received several queries about the extent to which NPS replaces the retirement benefits available to Government employees under the DB based pension system. Let me clarify that the NPS replaces only the pension benefits and is not a substitute for other retirement benefits like the gratuity, leave encashment, death-cum-retirement gratuity, etc. I believe that retirement benefits other than pension available to the employees covered by the NPS should be at par with the benefits available to other employees under the DB pension system. A high level Task Force appointed by the Government is already looking into this matter and is in the process of framing detailed Rules in this regard. I suggest that the State Governments may also undertake a similar exercise.

14.2 Another very important issue, which crucial to the success of NPS, is that of tax treatment relating to savings under the NPS. At present, NPS is subject to the EET tax regime. On the other hand, EPF, GPF and PPF have a more favourable tax treatment. EEE benefit is available to them. This goes against the basic philosophy of encouraging long-term 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. I hope that PFRDA's efforts in this direction will receive your support also.

## **CONCLUSION**

15. In conclusion, I would like to say that although the process of implementation of the NPS architecture for Government employees has now taken off, the way ahead is full of challenges. 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. All stakeholders in pension reforms will have to make special efforts to educate 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 choices to protect their own rights.

16. Government employees, who are today the sole subscribers under 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 its full potential will be realized in terms of economies of scale and the subscribers will gain substantially in terms of low fees and charges and high returns.

17. 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.