PFRDA(WPS):2022-23(1)

PFRDA WORKING PAPER SERIES

Perspectives on the Pension-Sector in India

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APRIL 2022

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I am happy to release the first Working Paper in thisseries by Dr. Deepak Mohanty, Member, PFRDA.

Supratim Bandyopadhyay
Chairman, PFRDA

Perspectives on the Pension-Sector in India

By

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India's pension-sector *(NPS plus APY), provides a flexible mode of old-age income-security not only for salaried employees but also to the common person. In the recent 5-years, 2017-18 to 2021-22, subscriber numbers have multiplied over three-fold led by APY; and assets under management by over four-fold led by NPS. The annual rates of return in various NPS schemes since inception in the range 9.0-12.7 percent and for APY at 9.4 percent have been very competitive vis-à-vis alternate saving instruments besides the primary benefit of steady income. The future expansion in NPS is expected to emanate from the private sector – both the salaried and self-employed. Steps at enhanced pension-literacy, both of the subscribers and the intermediaries, coupled with a nudge from the regulator and the Government along with encouragement to young-adults to join a pension scheme early would accelerate our movement towards a pension-society.*

JEL Classification: G25, H55

Key Words: APY, Income-Security, NPS, Pension

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Assistance by Shri Millind Khandate, Manager (PFRDA) & Smt. Indera Parcha is acknowledged.

I. Introduction

Pension, both as an instrument of financial savings and a means of old-age income security, ought to be a clear choice for an individual. In practice, however, that is not the case. In the early stage of employment when one starts saving, retirement is far from one's mind. Hence, in the formal-sector the employer's offering of choice of superannuation benefit, largely stemming from statutory requirement becomes the default choice. In India, for the non-government organized sector, it has mostly been the provident fund, offered by the Employees' Provident Fund Organization (EPFO), to which employers also are required to make a co-contribution. It does have a pension component for low-income contributors; Employees' Pension Scheme (EPS). In addition, insurance companies offer annuity-based pension; and some mutual funds provide medium- to long-term regular income schemes. All in all, these entities taken together still cater to a relatively small segment of population. This is for two main reasons: first, the labour force is largely in the unorganized sector; second, at the current level of per capita income, many workers don't generate adequate income to think about old-age income security.

India has an estimated population of 138 crore. For 2019-20, labour force was estimated at 56.3 crore, out of which 53.5 crore were in employment[1]. However, employment in the formal sector, where people can have some form of access to social security, is relatively small at 5.9 crore. The bulk of the labour force, estimated 43.2 crore, is in the unorganized-informal sector that does not have any statutory social security benefit. For the unorganized-informal sector there was no structured pension scheme till the introduction of Atal Pension Yojana (APY) in 2015. Against this background, this paper reviews the framework of pension system as has evolved globally, examines the Indian pension system, and concludes with some thoughts on the way forward.

II. Framework of Pension System

The framework of pension system as has evolved globally can be broadly cast into three pillars: Pillar-I: Non-contributory basic social pension financed mostly by the government. It could be universal or means tested. Pillar-II: Occupational contributory pension schemes which could either be voluntary or mandatory. It could be a defined contribution (DC) or define benefit (DB) plan. Pillar-III: Voluntary fully funded personal pension plans.

In the advanced countries, the pension sector is substantial partly stemming from large share of formal salaried employment. While the state provides some basic pension, it is not always funded, and thus is a pay-as-you-go scheme relying on current government revenue for pension payment. In 2020, pension assets in OECD countries were over US $ 34 trillion. In terms of GDP, they worked out to over 63 percent. In some of the OECD countries pension assets were over 100 percent of their GDP.

[1]Government of India: Economic Survey 2021-22.

III. Indian Pension System

Till the introduction of National Pension System (NPS) in January 2004, the main pension system was for government employees pay-as-you-go defined benefit plan. Many other institutions such as the defense, seamen's, railways, coal miners, Assam Tea Plantation etc. had their own independent pension plans. These schemes taken together could be considered as the categories of occupational pension that could be classified under Pillar-II. The private corporate sector mostly opted for provident fund under the EPFO. It may, however, be indicated that low income EPFO subscribers do have a component of pension. As of March 2021, the members under EPFO were estimated to be about 26 crore; but on an average only 4.6 crore members were contributing actively, and there were about 69.2 lakh pensioners.

There is no comprehensive Pillar-I. These are, however, a number of specific schemes such as Indira Gandhi National Old Age Pension Scheme (IGNOAPS) giving a pension of Rs. 200 per month to below poverty line (BPL) persons aged 60 years or above under the National Social Assistance programme (NSAP) which could be considered under Pillar I. The coverage under NSAP was around 4.2 crore beneficiaries. Life insurance sector has a core beneficiary of around 1.0 crore; mutual funds have about 27 lakh folios; and other entities such as coal miners have about 20 lakh provident fund beneficiaries. The coverage under Pillars I & II were not wide, till recently, to provide adequate old-age income security.

III. 1 National Pension System (NPS)

With the introduction of NPS which was made mandatory for government employees joining services from 2004, Pillar-II got an impetus. This scheme for government employees is a defined contribution plan with co-contribution from the government. The central and state governments (except two) are on the NPS. It was opened to all citizens in 2009 irrespective of their employment status. In other words, anyone in the age group of 18-70 years could open an NPS account. Subsequently, NPS was opened to the corporate sector in 2011. So, corporates have a choice to either go with EPFO or NPS for their employees.

NPS is also open to non-resident Indians (NRIs) and overseas citizen of India (OCIs). The moot point is that NPS as it stands today is available to one and all. While corporates have traditionally gone with EPFO, now they have an option to completely switch to NPS even with their legacy funds for their existing subscribers. Increasingly corporate are switching to NPS, but they have given an option to their employees to stay with either EPFO or NPS. Data shows that take-up rate among corporate employees for NPS remains low.

NPS is managed commercially by professional fund managers. The value of the pension corpus is marked-to-market and accordingly the rate of return is market determined. Hence, it is subject to variation on a daily basis. The subscriber is aware of the value of her portfolio on a daily basis, as investment is unitized and net asset value (NAV) of units is declared on a daily basis.

The subscriber though has a choice of her portfolio composition depending on her risk appetite – it could range from a predominantly equity-oriented scheme (maximum equity exposure of 75 percent of portfolio) to a full government-securities oriented scheme (maximum 100 percent of portfolio in government-securities). The subscriber does have the option to choose to actively manage her portfolio comparison.

In these choices while the risk attributes are well laid out, from a pensioner's perspective one needs considerable financial knowledge to make an appropriate choice. There is always risk-return tradeoff; investment horizon matters too. For instance, while an equity-oriented scheme gives significantly higher return compared to a debt-oriented scheme, the investment period has to be longer to harness the benefits from the equity- oriented schemes given the inherent higher volatility. Ideally, an equity-oriented scheme could be more suitable for younger investors. Conversely, a debt-oriented scheme could be suitable for older investors, considering that investors are allowed to join any time till their age of 70 years.

For the subscribers, it could be difficult to get the choice right on the first attempt. Hence, the schemes are so designed that they give flexibility to subscribers to change portfolio mix periodically. They can even change the fund manager if they are not satisfied with his performance. In order to help subscribers to make up their mind, there are also lifestyle auto choices which minimize risk of portfolio by diversification across asset class depending on the age of the investor. For example, as a subscriber advances in age the equity component is gradually reduced in a predetermined ratio with a corresponding increase in the debt component. Data shows that the majority of subscribers under all citizen model, around 70 percent, opt for auto choice. Even under active choice older investors (above 60 year of age) opt for less equity exposure compared to younger investors. These choices would seem rational.

One's NPS account is a unique account and is portable. One could be in and out of employment, could be with different employers at different times, still the same NPS account can be continued once opened. The moot point is that NPS is a highly flexible scheme without entry barrier as one could open an NPS account with a contribution of just Rs. 500.

While NPS is mandatory for government employees, it is not so for the private corporate sector. The government sector has completely switched to NPS, the organized non-government sector is still predominantly on provident fund system of the EPFO. NPS can also be considered as Pillar-III as anyone can open an NPS accounts as a voluntary contributory scheme.

III. 2 Atal Pension Yojana (APY)

Atal Pension Yojana (APY) was introduced by the Government in June 2015 as a part of the overarching objective of providing universal social security. APY is a pension scheme open to all individuals, including a common person, in the age group of 18-40 years. It is particularly aimed at under- privileged, unorganized and low-income individuals. The scheme design is very attractive. It is a defined-benefit and defined-contribution pension plan. A person knows beforehand how much she would have to contribute and what is the pension she will get.

It has triple benefits: First, it gives life-time monthly fixed pension in the range of ₹1,000-5,000 post 60-year of age depending on the person's choice and corresponding contribution. Second, the spouse gets the same amount of pension for life-time on subscriber's demise. Third, the accumulated corpus with interest is returned to the nominee on the demise of both the subscriber and spouse.

The average rate of return on APY since inception has been over 9.4 percent. Thus, APY is not only a pension scheme it serves as a long-term saving instrument. It is also risk free: guaranteed by the Government and administered by the pension regulator, PFRDA.

It may be mentioned that once having joined the scheme, there is merit in regular payment to harness its multiple benefits. There is convenient option for payment on monthly quarterly and half-yearly frequently; further the subscriber has the option to either upgrade or downgrade the pension amount with corresponding change in installment. In case a subscriber is not able to continue for some reason, she gets back her accumulated contribution with interest. Thus, both entry and exit in APY are easy, and almost costless.

IV. Progress of Pension-Sector in India[2]

Since the introduction of NPS, and more recently APY, the pension sector has expanded in India. Total number of subscribers have increased over three-fold from 1.5 crore in March 2017 to over 5.2 crore by March 2022. In terms of numbers, as could be expected, it is dominated by APY. Total number of APY subscribers (including its earlier version, NPS Lite), increased over four-fold from 93 lakh to 405 lakh (**Table-1**). APY subscribers account for over 78 percent of pension subscriber base **(Chart-1).**

The pension assets under management have increased over four-fold from Rs.1,75,000 crore to Rs.7,37,000 crore during this 5-year period. The bulk of the assets is held by NPS, which rose from Rs.1,70, 000 crore to Rs. 7,11,000 crore, accounting for 96 percent of total assets; the balance4 percent being contributed by APY **(Table-2 & Chart-2).** NPS in the private sector, that included corporate and all citizen model, accounts for 16 percent of total assets. Thus, while the pension numbers are driven by APY, pension assets are led by NPS.

Disaggregated APY subscriber data shows improvement in gender mix with female subscriber share rising from 37.6 percent in March 2017 to 44 percent by March 2022; age mix is also rising in favor of younger cohort in the age group of 18-25, from a share of 32 percent in March 2017 to 44 percent by March 2022. However, the bulks, about 77 percent, of APY accounts were for a pension amount of Rs. 1,000 per month followed by 15 percent for Rs. 5,000 with the remaining 8 percent in-between. The overwhelming share of Rs.1,000 pension in APY could be due to several factors, the predominant cause being economic, with the target population being low-income households where day to day consumption expenditure takes precedence over savings.

A survey by PFRDA on socio-economic characteristics of NPS subscribers (all citizen models) for the 5-year period 2016-17 to 2020-21 showed that 24 percent were female subscribers with the balance 76 percent being male subscribers. This is in contrast to a better gender balance in the case of APY. Majority of the enrolments was from the age group of 26-35 years (33 percent) and 36-45 years (31 percent). Most of the subscribers were highly educated: over 81 percent of the subscribers were graduates or with higher qualifications.

Table 1: Pension Sector has Expanded Rapidly

Number of Subscribers in lakh

[2] Pension sector is taken as NPS and APY (including NPS Lite) for the purpose of analysis here.

Sector	March 2017	March 2022	Growth (%)
I. NPS	61.4	115.5	88.1
Central Government	17.9	22.8	27.4
State Government	33.3	55.8	67.6
Corporate	5.9	14.0	137.3
All Citizen Model	4.4	22.9	420.5
II. APY (including NPS Lite)	92.9	404.6	335.5
III. Total (I + II)	154.4	520.2	236.9

Chart 1: Expansion in Numbers is led by APY

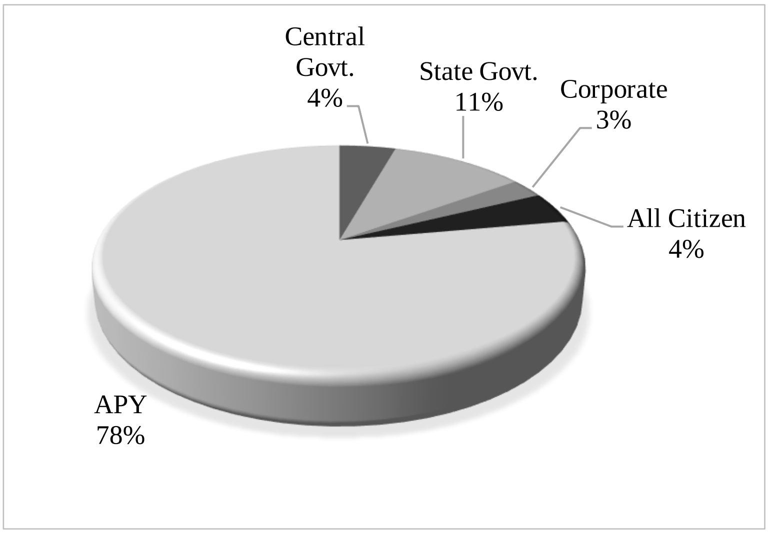
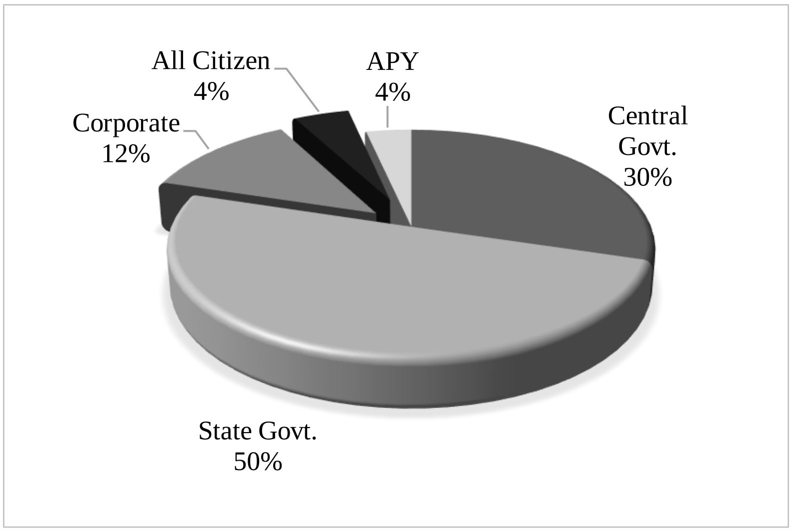


Table 2: Bulk of these Assets is held by NPS

Assets under Management in Rs crore

Sector	March 2017	March 2022	Growth (%)
I. NPS	170036	710983	318.1
Central Government	67040	218577	226.0
State Government	84917	369427	335.0
Corporate	14953	90633	506.1
All Citizen Model	3126	32346	934.7
II. APY (including NPS Lite)	4524	25609	466.1
III. Total (I + II)	174561	736592	322.0

Chart 2: Future Growth will be led by Non-Govt. Sector



Most of the subscribers were from relatively high-income group: two-thirds of the enrolments were from the income group of Rs 5-10 lakh (36 percent) and Rs 10-25 lakh (30 percent). Among various states, enrolment from Maharashtra was the highest, accounting for 17 percent.

Going forward, NPS (private sector) is poised to expand rapidly as increasing number of corporate employees and relatively better off households, for example self-employed and professionals such as doctors, lawyers and small business owners see the merit of joining NPS. There is a potential for NPS in rural areas for larger farmers and traders and those with lumpy income as NPS does not require a standard monthly contribution.

The rate of returns in various NPS schemes since inception in the range 9.0-12.7 percent has been very competitive vis-à-vis alternate saving instruments. In the last five years the range has been 8.1-13.3 percent. As could be expected, equity-oriented NPS scheme has clocked an annual return of 13.3 percent. An ultra-conservative government-securities-oriented NPS scheme has posted an annual return of over 8 percent. APY has also posted high average annual return of 8.8 percent in the last 5 years, with annual return since inception being 9.4 percent **(Table-3).**

The coverage of population in pension under these two schemes (NPS & APY), during the 5-year period 2016-17 to 2021-22, has raised from 1.2 percent to 3.7 percent as share of total population; and assets as a proportion of GDP has increased from 1.2 percent to 3.2 percent **(Table-4)**. This will suggest that the pension-sector, though started late, is progressing much faster than the nominal growth of the economy as well as population. Impressive as these numbers are, they pale in comparison with development in a number of other countries. For example, almost everybody in OECD countries have access to pension in some form or other, which doubles as old-age social security benefits.

Table 3: Average Annual Returns is led by Equity Oriented Schemes

(In percent)
As on 31st March 2022

Scheme	1 year	5 years	Since inception
Equity (E)	19.0	13.3	12.7
Corporate Bonds (C)	6.3	8.2	9.6
Government Securities (G)	4.0	8.1	9.0
Central Govt. Scheme (CG)	6.9	8.7	9.7
State Govt. Scheme (SG)	6.8	8.6	9.6
Atal Pension Yojana (APY)	6.9	8.8	9.4

Table 4: Progress of Pension Sector (NPS & APY)

Scheme	2016-17	2021-22
Coverage (NPS+APY) as (%) of total population	1.2	3.7
Assets under Management (NPS+APY) as (%) of GDP	1.2	3.2

V. Conclusion

First, these are early days for the pension sector in India. There is tremendous scope for growth as our per capita income rises further and we transition to a high middle-income country. Our demographic structure, with a greater proportion of younger people, favors a phase of accumulation. Since longevity is inching up, so also the need for a steady stream of income is increasing to mitigate old-age poverty. Further as the traditional family support system changes with increasing urbanization there is even a greater necessity for an independent source of income in old-age. Given the fiscal-situation, the Government may nudge people towards NPS as already been done for government employees.

Second, as the pension sector progresses there will be a need for a sound regulatory architecture to ensure that pension funds are managed on prudent lines while safeguarding overall financial stability. In this direction, the Pension Fund Regulatory and Development Authority (PFRDA) became as statutory pension sector regulator in February 2014. PFRDA has the oversight role over the pension sector; and has taken a number of steps to ensure that the intermediaries involved in the relevant pension architecture function seamlessly. On boarding and exit of pensioner have been made easy with greater usage of technology. While there is a mechanism for quick redressal of pensioner grievances, it is being further strengthened.

Third, financial literacy becomes important for people to reap the benefit of the formal financial sector. Having reading or writing ability is not enough for financial literacy. Financial literacy is a major challenge not only in emerging market economies like ours but also in advanced economies. Literacy not only of the end-users such as the pensioners but also for the service providers and other intermediaries involved in the whole chain of service delivery. This calls for a multi-pronged strategy. This has got the attention at the highest level of financial regulators and the Government under the aegis of Financial Stability and Development Council (FSDC). There is a national strategy for financial inclusion which is being implemented on an ongoing basis. At the same time each regulator including PFRDA have taken a number of steps to enhance financial education so that the consumers make informed decision and reap the benefit of the formal financial sector while being cognizant about risks and various tradeoffs involved. These include pension education through print and electronic media, outreach programme including through trade bodies, intermediaries such as banks and town-hall events. There are many facets to pension literacy: a single pension account for the family is not adequate; women in the family must have a pension account given their higher longevity; it is prudent to empower young adults particularly students with a pension account so that they imbibe the financial discipline of long-term saving.

Forth, financial inclusion and empowerment will remain incomplete without each member in a family having got a pension account. In this direction, given the nature of the pension product where the payoff is not immediate, it needs a nudge by all concerned – the employers, intermediaries, the Government and the pension regulator – to induce people, particularly young adults to join a pension scheme. There is immense merit in joining young, as with small contributions sizeable corpus could be accumulated given the power of compound interest rate, providing substantial steady income in one's post-working life.

To sum up, India's pension-sector (NPS *plus* APY), provides a flexible mode of old-age income-security not only for salaried employees but also to the common person. In the recent 5-years, 2017-18 to 2021-22, subscriber numbers have multiplied over three-fold led by APY; and assets under management by over four-fold led by NPS. The annual rates of return in various NPS schemes since inception in the range 9.0-12.7 percent and for APY at 9.4 percent have been very competitive vis-à-vis alternate saving instruments besides the primary benefit of steady income. The future expansion in NPS is expected to emanate from the private sector – both the salaried and self-employed. Steps at enhanced pension-literacy, both of the subscribers and the intermediaries, coupled with a nudge from the regulator and the Government along with encouragement to young-adults to join a pension scheme would accelerate our movement towards a pension-society.

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