NPS: A Flexible Pension Scheme for All[1]

I thank the Outlook Money for inviting me to speak on 'Pension' which is of importance to all of us. I propose to focus on the National Pension System (NPS) in the context of today's theme.

Forty years of age is an important stage of life wherein one looks back while looking into the future, both professionally and financially. Prudent financial planning, particularly retirement planning, early in one's career becomes important for financial wellbeing.

Dictates of Demography

Why should retirement planning take a center stage while approaching the age of 40 ? To appreciate this, it is useful to reflect on our demographic trend. The average expected life at the age of forty is about 35 years.[2] Going forward, it is projected to improve and in coming years may touch 40 years. So, at this stage (age 40), the person gets to reflects on where does one stand in terms of attaining his important financial goals, particularly retirement planning, that is essential to live a dignified retirement life post superannuation.

India currently is the fastest growing large economy in the world. At the same time, it also is projected to age rapidly. The share of population over the age of 60 years is projected to increase from 10.5 percent in 2022 to 20.8 percent by 2050.[3] This Aging is likely to accentuate as every fifth Indian is expected to be over 60 years of age by the middle of this century. Further, the old-age dependency ratio is expected to increase from 18 percent in 2020 to 30 percent in 2050 exerting pressure not only on our younger generation but also on our overall financial resources.[4]

Longevity of present and future generations of Indian would be much higher. Living longer implies that one needs money for a longer period to take care of oneself when one is not able to work to earn for themselves. The retirement phase becomes more challenging because of the increase in medical expenses, increasing nuclear family structure, and limited access to formal credit facilities. Thus, with every passing year after superannuation, one gets exposed to financial risks unless adequate provision has been made to take care of retirement.

[1] Keynote speech by Dr. Deepak Mohanty, Chairperson, Pension Fund Regulatory and Development Authority (PFRDA) at Outlook Money-'40 AFTER 40', New Delhi, October 04, 2024.

[2] SRS based abridged life tables 2016-20, Census of India.
[3] UNFPA India Ageing Report 2023.
[4] Aging Well in Asia: Asian Development Policy Report 2024.

I may underscore that women are more exposed to longevity risk as compared to men: world over women live 2-3 years more than their male counterparts. In India, the expectation of life at age 60 was estimated as 19.2 years for women as against 17.5 years for men.[5] Therefore, as we navigate through the complexities of our evolving socio-economic landscape, the role of pension in securing the future for our elderly citizens is very crucial.

In the past, pension was perceived to be the privilege of government employment. It is no longer so with the introduction of the National Pension System (NPS) in 2004, first for the government employees, and then extended to private corporates including the common person, and now to children with the scheme of NPS Vatsalya, which was recently launched by the Government.

NPS Vatsalya can be seamlessly ported to workplace pension on the child coming of age and joining the workforce, thereby providing continuity to one's retirement savings account. Thus, now any member of the family from infancy to 70-years old can join NPS. As the vesting period is enlarged, one could harness the power of compounding to accumulate substantial corpus providing adequate pension on one's retirement. The concept of compounding is not easily understood. For instance, with an annual return of say 8 percent, Rs. 100 could grow 10 times in 30 years but 101 times in 60 years.

NPS offers Flexibility

The introduction of the NPS in India marked a paradigm shift in transition from a defined benefit (DB) to a defined contribution (DC) system enhancing the stability of out pension system. The growth of NPS resulted in a notable 7.82 crores subscriber enrolments (NPS and APY combined) and asset under management (AUM) growing to over Rs 13.4 lakh crore. At present, NPS has subscriber base of 1.54 crore, 94 lakh from government and 60 lakh from private sector including the common person. NPS provides a robust platform to provide pension product for all the strata of our society. The uniqueness of NPS not only lies in its low-cost structure but also the flexibility it offers.

[5] UNFPA India Ageing Report 2023.

First, digitisation played a crucial role in our NPS. It offers flexibility in onboarding, one can subscribe NPS through offline or online mode. For offline one can visit any nearest branch of registered Point of Presence (PoP) such as banks available across the nation. Thus, enabling a convenient and faster onboarding process. Under online mode, there are various options available such as onboarding using net banking, mobile apps or eNPS.

Second, NPS offers flexibility in terms of making contributions to the scheme. One can invest any amount without any ceiling. Under NPS – Corporate model, there is flexibility of contribution either by employer or by employee or by both. The NPS account remains active, only with an annual contribution of Rs. 1000. It is not necessary to contribute every month. Thus, NPS is suitable for people or small businesses with irregular income.

Third, NPS offers flexibility of selecting Pension Funds. One can select any of the currently 11 Pension Funds registered with PFRDA and can also change it once in a year, if the performance of fund managers doesn't meet expectation.

Fourth, NPS provides ample flexibility in terms of asset allocation. It offers auto choice and active choice as major types of asset allocation. In auto choice, one gets to select any one of the life cycle funds out of four viz. LC25, LC 50, LC 75 and recently launched balance life cycle fund (BLC). In active choice one can make asset mix among asset classes viz. equity, corporate bond and government securities with appropriate proportion depending upon one's risk appetite; one can invest upto 75 percent in equity. In BLC, the equity allocation upto 50 percent is maintained until the age of 45 and tapering of equity starts thereafter, instead at the age of 35, in the other life cycle funds.

Fifth, the change in asset allocation is allowed once in a quarter which is effectively four times in a financial year. This provides an opportunity to an active investor to realign her portfolio with the economic cycles to earn optimal returns.

Sixth, at the time of exit, minimum 40 percent of the corpus is annuitized, the balance maximum of 60 percent could be withdrawn as lumpsum; both tax free. Annuity can be purchased from any of the 15 empanelled annuity service providers, i.e. insurance companies. Additionally, the option of selecting the annuity variant is also available for subscribers. We have allowed the deferment of annuity and lumpsum amount on superannuation age. Subscriber can defer his/her exit and stay invested in NPS upto 75 years of age. Additionally, the subscriber has an option to withdraw the lumpsum amount in the form of Systematic Lumpsum withdrawal (SLW) in a phased manner upto the age of 75 years or withdraw anytime the entire amount.

Competitive Returns and Tax Efficiency

Besides being low cost and flexible, what make NPS attractive is its competitive returns. For instance, as of September 2024, the equity scheme of NPS has given a compound annual growth rate (CAGR) of 14.5 percent return since inception, Corporate bond 9.1 percent and government securities 8.9 percent. Similarly, the scheme for Central government employees, which is a mix of both debt and equity, has given a CAGR of 9.6 percent return since inception.

The tax advantage that NPS offers makes NPS a desirable product in one's retirement planning. Contribution to NPS is tax efficient both for the employer and employee. The Union Budget 2024-25 raised deduction of expenditure by employers (Section 36 of Income Tax Act) towards NPS contribution from 10 percent to 14 percent of the employee salary. Similarly, deduction of this amount upto 14 percent of salary from income of employees (Section 80CCD (2) of Income Tax Act) is allowed under the new tax regime. Both the corporate and employees benefit from this provision by subscribing to NPS. Under the old tax regime, for individuals, NPS has an additional tax benefit for investment upto Rs. 50,000 under section 80CCD (1B) on top of Rs. 1.5 lakh under 80 CCD (1), deductible from income.

Regulatory Initiatives

Over the period, PFRDA has undertaken several key initiatives for orderly growth of the pension sector while promoting old-age income security. Emphasis is on simplifying processes and strengthening security within the NPS ecosystem. This includes providing flexibility to choose among Central Record Keeping Agencies (CRAs), enabling contributions through various modes including Bharat Bill Pay, expanding investment universe, increasing usage of technology and ensuring cybersecurity. These initiatives align with the broader objective of financial inclusion and thus striving towards old age income security of a diverse demography.

Other notable initiatives include the introduction of same-day investment of contributions (T+0), choice of multi-pension schemes, mandatory penny drop verification to prevent fraud, and the Anti-Money Laundering (AML) declaration on e-NPS platforms. Overall, these initiatives by PFRDA underscore its proactive approach in managing and safeguarding the NPS, ensuring that it remains a robust and secure investment vehicle for the subscribers. Further, I may share that as was envisaged in the Union Budget: 2023-24, PFRDA has undertaken comprehensive review of all the extant 11 market-facing regulations to simplify, ease, and reduce the cost of compliance.

Conclusion

Let me conclude, NPS is a low-cost flexible pension scheme for all. Notwithstanding its user friendly features, sustained efforts are warranted to enthuse that employees in private corporate sector, small businesses, professionals, women and parents for their children to join NPS for achieving "pension saturation". It is important to mention that our current Pension Assets to GDP ratio is around 16.5 percent while the same ratio of developed countries like the UK, the US and Australia is over 100 percent of their GDP, the same ratio of OECD Countries was 82 percent in 2023. NPS assets are about 4.5 percent of our GDP. This suggest that the Indian Pension industry is still evolving and there is a long way to go.

We at PFRDA are committed to protecting the interests of its subscribers and fostering trust in the pension ecosystem through continuous improvements in security, transparency, and operational efficiency.

Once again, I thank Outlook Money for inviting me to interact with you.

Thank you.

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