Concept Note on Auto Enrolment for increase in pension coverage in India

I. Introduction

Pension or old age income provision is an important component of the social safety net. It provides a mechanism to alleviate or reduce the risk of old age poverty and a means to smoothen lifetime consumption to maintain living standard after retirement. Pension system must be affordable to the subscriber and fiscally sustainable to the economy so as to achieve the primary objective of old age income support. The need for pension reform in India was driven by the budgetary strain of civil services unfunded defined benefit pay as you go pension liabilities on the one hand and the need to expand the coverage of old age income security to the vast unorganized sector on the other.

2. To adapt pension systems to fiscal imperatives and demographic trends, and pursuant to reports of various expert committees, India made a conscious move to shift from the defined benefit pay-as-you-go public pension system to defined contribution funded pension system initially called the New Pension Scheme now renamed as National Pension System (NPS). NPS was made effective from 1st January 2004 initially for Central Government employees other than the armed forces . Subsequently, from May 2009, NPS was extended to the private sector including the unorganized sector on a voluntary basis. In October 2010 government launched the NPS Lite – Swavalamban Scheme for the under privileged workers in the unorganized sector. In May 2015 the Atal Pension Yojana (APY) was launched with a minimum guarantee pension and co-contribution by the Government of India (for certain eligible subscribers) focusing primarily on the under privileged workers in the unorganized sector. With these efforts, the coverage of the NPS under the voluntary segment and APY as measured by the enrolments has been picking up.

3. As on 30th June 2016 there were 12.9 million subscribers with Assets Under Management of Rs.1.32 lac crore. Central and State Government employees account for 36.6% of the total subscribers and 88.6% of Assets Under Management under NPS and APY. Corporate and Unorganized Sector (all citizen model) just 5.7% of the subscriber and 9% of Assets Under Management. NPS-Lite/ Swavalamban and APY accounted for 57.7% of the subscribers and just 2.3% of the Assets Under Management. A perusal of the last column of Table 1 reveal that the average Assets Under Management per subscriber were Rs.1,02,000. Segment wise the average AUM per subscriber were Rs. 3.09 lakh for central government NPS beneficiaries/ employees, Rs.2.12 lakh for state government NPS beneficiaries/ employees, Rs.2.12 lakh for the corporate NPS beneficiaries/ employees, Rs.57,000 for unorganized/ all citizen beneficiaries, Rs.5000 for NPS Lite/ Swavalamban subscribers and Rs.3,000 for APY subscribers. The coverage under the corporate and all citizen model has not been an encouraging one. This is partly due to NPS not being fully extended the EEE tax treatment i.e. exemption from tax of contribution, exemption of returns during accumulation and exemption of benefits on superannuation. It is felt that as NPS competes with retirement products like EPF, CPF, superannuation funds etc., once a level playing field is provided to NPS viz-a-viz the other products, the response of the corporate sector and high income group self-employed individuals such as lawyers, doctors, accountants, etc would be much better than what it is now. Under NPS Lite/ Swavalamban while there are fairly large numbers of subscribers registered, the average per head AUM is just Rs. 5000. It is a moot question whether their accumulated pension corpus would be large enough to get a pension of say Rs.1000 per month even after being in the system for 20-25 years. As on 30th June 2016, the number of subscribers covered under different segments, the corpus/ contributions mobilized from them and the assets under management are given in Table 1:

Table 1: Status of NPS and APY as on June 30, 2016.

Sector	Number of Subscribers	Total Corpus (Rs Crores)	Total Assets Under Management (Rs. Crores)	Assests Under Management per subscriber (Rs. In Lakhs)
Central Government	1,696,118	38,767	52,398	3.09
State Government	3,037,503	52,653	64,328	2.12
Total	4,733,621	91,420	116,726	2.47
Corporate	497,618	9,100	10,551	2.12
Unorganized	238,085	1,452	1,361	0.57
Total	735,703	10,552	11,912	1.62
NPS Lite	4,463,740	1,038	2,279	0.05
APY	2,998,951	754	795	0.03
Total	7,462,691	1,792	3,074	0.04
Grand Total	**12,932,015**	**103,764**	**131,712**	**1.02**

Number of subscribers, corpus and AUM as percentage of total subscribers, corpus and AUM respectively are given in Table 2:

Percentage of subscribers, Corpus and AUM under different segments of NPS and APY as on June 30, 2016

Sector	Number of Subscribers (% of Total)	Total Corpus (% of Total)	Total Assets Under Management (% of Total)
Central Government	13.1	37.4	39.8
State Government	23.5	50.7	48.8
Total	36.6	88.1	88.6
Corporate	3.8	8.8	8.0
Unorganized	1.8	1.4	1.0
Total	5.7	10.2	9.0
NPS Lite	34.5	1.0	1.7
APY	23.2	0.7	0.6
Total	57.7	1.7	2.3
Grand Total	**100.0**	**100.0**	**100.0**

4. In many countries, to increase the coverage under private pension system, besides mandatory pension system to the organized sector, "soft compulsion", generally known as **automatic enrolment** in private pensions with an option to the subscriber to opt-out, has been introduced. It may be pertinent to mention here that compulsion/ mandatory provision has limitation to the extent that it can be enforced in places where the contours of the employer-employee relationship are well defined, while purely voluntary pension options run the risk of underserving the purpose of

savings for pension. Automatic enrolment is somewhere in between the alternative approaches of compulsion/ mandatory and voluntarism. It is often therefore called "soft compulsion". The idea is that the employer, wherever employer employees' relationship can be established (whether formal or informal), should be under an obligation to register all his employees/ workers under the pension scheme without any underlying obligation to contribute mandatorily for such employees' pension/ old age income security. Persons so registered have the option to opt out from such pension scheme. The aim is to increase coverage and participation under pension/ old age income security while preserving individual choice of not doing so.

5. Surveys on individual preferences relating to saving propensity and financial literacy, both within India and overseas such as in OECD countries (2005b), have routinely found that people by and large, agree that savings for retirement are important and that they feel that they should be planning for old age. Unfortunately, this often does not translate into action as inertia and procrastination predominate the scenario and the retirement needs, though inherent, is not considered imminent. An obvious reason for this is that the process of signing up for a pension plan can be long and complex. Another problem is lack of awareness/ information about retirement savings options and insufficient understanding of complex investment decisions. Automatic enrolment is designed to bring such people within pension/ old age income security coverage.

II. International Experience

6. A number of employer-provided pension plans in the United Kingdom and the United States have long used automatic enrolment to increase coverage among their employees. However, the policy has recently become much more prominent. The increase in private pension coverage following the introduction of automatic enrolment has been significant in Italy, New Zealand and the United Kingdom.

Italy

7. In ***Italy***, the automatic enrolment programme was implemented in 2007 for all employed workers in the private sector as a part of a major reform process that aimed to improve participation in the occupational private pension funds. The automatic enrolment programme offered a choice for the private sector workers to transfer flows of severance pay provision – known as Trattamento di Fine Rapporto (TFR) – into a pension fund or to keep their rights regarding the TFR unchanged.[1] By default, in the event workers do not make an active choice within a six-month period, the TFR would be transferred to the pension fund (usually chosen by labour agreements).

According to COVIP, the Italian pension supervisor, the reform involved about 12.2 million. In the space of one year, the working-age population coverage rate increased from 8.5% to 11.9%.

New Zealend

8. The Kiwi Saver in ***New Zealand*** in 2007, a national voluntary work-based saving scheme, is administrated by the Inland Revenue Department. Employees are automatically enrolled in the KiwiSaver scheme when starting their first job or when switching jobs if they do not yet belong to KiwiSaver are eligible to join. Main eligibility conditions include: to be aged between 18 and 64, be a New Zealand citizen or resident, and be in employment for more than four weeks. Where employer linked KiwiSaver schemes have defined membership criteria and new members are not eligible to join, employees can join a KiwiSaver scheme of their choice or the IRD will allocate them to a default KiwiSaver scheme, allowing three months' time for selecting their own scheme. If no active choice is made during the three months, the IRD confirms enrolment in the default scheme. Individuals under the age of 18, self-employed, and non-working

[1] Companies with 50 or more employees were mandated to transfer to the Treasury the TFR flows that employees decided not to pay to the pension fund (thus keeping unchanged their rights regarding the TFR). In 2008, the TFR flow paid to the Treasury totaled 5.3 billion Euros.

individuals[2] can join the programme on a voluntary basis by directly contacting a KiwiSaver provider. The government contributes an initial payment of NZD 1,000, which is offered to all members. In addition, the government provides flat subsidies and contributes via an annual 'member tax credit' (MTC) for contributing members. For work-based KiwiSaver schemes, the Inland Revenue collects KiwiSaver members' and employers' contributions and transfers them to KiwiSaver providers. The scheme reversed the previous negative trend on private pension coverage. From a low 15.2% coverage of the population under 65 at the end of 2007, coverage of private pensions increased rapidly since then to reach 64.4% at the end of 2013.

United Kingdom

9. In the ***United Kingdom***, all the eligible workers are required to be enrolled into an automatic enrolment scheme, an existing (qualifying) workplace pension scheme, or the National Employment Savings Trust (NEST), the default qualifying workplace scheme. NEST is an automatic enrolment trust-based low-cost DC pension scheme established by the government to support the introduction of automatic enrolment, which has a public service obligation to accept all employers. The proportion of employees in a workplace pension scheme increased in April 2013 to 50%, the first increase since 2006. In 1997, 55% of employees were members of a workplace pension scheme, falling to 47% in 2012, prior to the introduction of automatic enrolment (Office for National Statistics, 2014). According to the Department for Work and Pensions (DWP), focusing on private sector employees, their coverage rate rose from 26% in 2011 to 35% in 2013 (DWP, 2014a). This was the first increase for a decade. These numbers suggest that the introduction of automatic enrolment already had an effect in 2013. As more employers reach their staging date, the increase in coverage is expected to continue. At the end of August 2014, 27 818 employers had completed their declaration of compliance and automatically enrolled 4 426 000 eligible jobholders into a pension scheme (The Pensions Regulator, 2014a).

[2] For self-employed or unemployed persons, there is no defined contribution rate; a regular contribution amount is agreed with a selected provider. Tax credit is also available to the unemployed and the self-employed.

Canada

10. It is still too early to see the impact of the introduction of automatic enrolment in ***Canada***. Indeed, following the passage of federal legislation in 2012, the first provinces to introduce Pooled Registered Pension Plan (PRPP) legislation in Canada (Saskatchewan, Alberta, British Columbia and Quebec) did so in 2013. There is no obligation for other provinces to introduce PRPP legislation. Only the federal and Quebec legislation are in force in 2014. The impact on coverage will only be observable when 2014 membership data become available. However that the coverage rate of private pension plans in Canada has been quite stable since 2000, at around 21% of the working-age population.

Chile

11. For ***Chile***, the automatic enrolment programme for self-employed workers was developed as a part of the process of mandatory affiliation of the self-employed into the pension system. The coverage is the self-employed workers who receive income taxable under Article 42, No. 2 of the Chilean Income Tax Law[3]. Self-employed workers, who do not fall in this category, may contribute to the system on a voluntary basis. Contributions by the self-employed workers are transferred to individual accounts in private pension funds managed by Pension Funds Administrators (AFPs). The Inland Revenue Service (SII), the entity responsible for determining the amount of the contributions that the self-employed workers must pay to the pension system each year, withholds 10% of the amount of each invoice or receipt for professional services provided by the self-employed workers to their clients to make provisions for the tax payment, which will then be transferred to pension fund administrators in the form of contributions.

[3] Article 42 No. 2 refers to individuals who give an invoice or receipt for professional services provided to clients. The invoices or receipts represent the self-employed workers' income and form the basis for an assessment of their contributions. If a worker receives income and wages from one or more client/employer simultaneously, all covered wages and income are totalled for the purposes of calculating the maximum yearly limit.

12. The impact of the automatic enrolment of self-employed people does not translate into higher coverage rates when the working-age population is used as the denominator. However, according to the Chilean Superintendence of Pensions, 304 011 self-employed individuals, representing 32% of those affected by the policy, automatically contributed to the pension system in 2013 based on their self-employment earnings of 2012. Only 11% of them did not have a defined contribution (DC) account before and became new members of the pension system (all the others were already members of the pension system). In addition, 60% had already contributed to the pension system as employees during the year, so their contributions as self-employed came to fill the gap of contributions for the total income earned (as employee and self-employed). Preliminary data show that 254 295 self-employed individuals contributed in 2014 for their self-employment earnings of 2013. The objective of the automatic enrolment programme in Chile is therefore more to increase the number of people contributing permanently and for their total earnings to the pension system rather than to increase coverage (which already stood at around 77% of the working-age population before the reform.

United States

13. In 2006, in the **United States** the adoption of the Pension Protection Act greatly encouraged automatic enrolment by giving employers incentives to automatically enroll their employees into a retirement saving plan. There are two government agencies with the authority to regulate and enforce provisions with respect to automatic enrolment: the DOL and the Internal Revenue Service (IRS). The DOL responsible for enforcing the provisions that govern the conduct of plan fiduciaries, the investment and protection of plan assets, the reporting and disclosure of plan information, and participants' benefit rights, development and publication of a variety of educational materials for consumers and plans sponsors, and the operation of the nation-wide free hotline providing individual assistance to participants and plan sponsors. The IRS addresses tax-related issues associated with retirement savings (e.g. qualifying as a

plan, filling annual reports) and has primary jurisdiction over participation, vesting, and funding requirements.

14. Following the adoption of the *Pension Protection Act* (PPA), membership in 401(k) plans has remained broadly constant in the United States. According to the US Department of Labor (2013), since 2005, coverage increased from 27.5% of the working-age population to 29.1% in 2006 and 29.4% in 2011. Although, at the aggregate national level, the impact on coverage of automatic enrolment may seem to be small, there is a lot of literature in the United States documenting the positive impact of automatic enrolment on participation rates at the company level. For example, the US Government Accountability Office (GAO) reviewed available reports and data about the effect of automatic enrolment policies. According to studies they reviewed, automatic enrolment policies resulted in considerable increases in 401(k) participation rates for plans adopting them, with some participation rates reaching as high as 95%. For example, one study followed comparison groups hired before and after a company adopted automatic enrolment for new employees only and compared the participation rates of the two groups. The participation rate for those hired before automatic enrolment was adopted was 37% at 3 to 15 months of tenure, compared with an 86% participation rate for the group hired after automatic enrolment with a similar amount of tenure. One of the reasons why the impact of automatic enrolment at the company level is not visible at the aggregate national level may stem from the fact that many companies introduce automatic enrolment for new employees only, leaving existing employees outside the programme. In addition, private pension coverage in the United States is contingent on employer sponsorship and strongly correlated on earnings, age and other factors that may have had a greater impact on coverage rates than the new automatic enrolment regulation during the period subsequent to the enactment of the PPA, which coincides with the more widespread impact of the global financial crisis beginning in 2007.

III. Requirement of Auto enrolment in India

15. India has a huge unorganized or informal sector, around 83% of the workers are in informal employment where there is no formal employer – employee relationship. The job/ work arrangements are informal, not governed by any enforceable contract. Hence, the employees or workers are not covered under any kind of old age income security scheme. Further, a large number of workers are self-employed in the agriculture sector, small businesses – tea stalls, street vendors, hawkers, rickshaw pullers, domestic helpers, maids, drivers, cooks, etc. As per NSS, 66th Round (2009-10), 65.6 percent of the total workers were employed in enterprises employing less than 6 workers, 10.5 % were employed in enterprises with 6 and above but less than 10 workers, 6.8 % in 10 and above but less than 20 and 17.1 % in the enterprises with 20 and more workers. All the workers employed in enterprises with 20 or more workers are required to be mandatorily covered under Employees Provident Fund and Miscellaneous Provision Act, 1952. However, the workers employed in rest of the enterprises, excluding some high income self-employed professionals such as doctors, lawyers, accountants etc. for which no separate data is available, are not covered under any pension scheme. A mandatory scheme for such workers is just not possible. Voluntary schemes such as the NPS Lite/ Swavalamban and Atal Pension Yojana which are primarily focused on this category of workers have also not witnessed very encouraging response. It is also an internationally accepted fact that extending pension to the workers on voluntary basis is not very successful. It is in this context that an auto enrolment is being proposed to expand coverage of pension/ old age income security to a larger segment of the society.

16. Atal Pension Yojana (APY) is ideally suited for the informal sector, especially to relatively better salaried low and middle income segments, and it is our view that APY could be offered on auto enrolment basis to these components of the informal sector. These segments would be Micro Industries, Small Scale Industries, Asha Workers, Aanganwadi Workers, etc. These groups have employer – employee or similar

relationships and would therefore make them amenable to auto enrolment. APY can be offered on auto enrolment basis to these groups in the informal sector.

IV. Target Group- Who will be auto enrolled into the pension system?

17. Employers / Organisations/Departments employing/ engaging any person whether formally or informally will be asked to automatically enroll them into Atal Pension Yojana provided:

a) They are citizens of India and are in the age group of 18 – 40 years (proposed to be extended to 50 years).

b) There will be no obligation for the employers/organisations/depts. to contribute to the pension of the employees/ members so enrolled. However, if they do, they will be eligible for tax deduction from their income to the extent of their contribution to the employee.

c) Employees and workers in private sector, government, semi-government organizations like Micro Industries, SSI units, Anganwadi, Asha workers, Construction Boards, Gram Panchayats, NGOs SHGs, etc. will be targeted. The govt. and semi-govt. organisations to be associated in this regard by concerned Depts. of the Central and State govts.

d) Non-compliance may not be penalized, in the initial stages. Mass awareness is required to be done for adoption of auto-enrolment.

V. Modalities for auto enrolment

18. The auto enrollment in pension system would be applicable to employees/ members of Micro Industries, SSI units, Anganwadi workers, Asha workers etc. who are beneficiaries of govt. scheme.

19. Enterprises which could be sole proprietorship, partnership etc. with less than 19 employees[4] will be required to automatically enroll all their full-time employees into

[4] This will require legislative backing even if the employers contribution is voluntary

APY. Employer contribution towards the pension will be voluntary. The employee will be given option to opt out of the system any time after one year following automatic enrolment. Contributions already made will be refunded after adjustment of account opening, maintenance etc. charges. Employers must automatically re-enroll their eligible jobholders who chose to opt out or cease active membership on a three-yearly cycle. This will give employees opportunity to reconsider their decision to opt out at regular intervals in case their situation has changed since then.

i) Informal sector groups to be covered:

- Micro Industries and Enterprises
- Small Scale Industries
- Asha
- Anganwadi
- Construction Sector
- Gram Panchayat and other organisations as may be identified from time to time

ii) Contribution:

There are five schemes under APY, providing guaranteed pension of Rs. 1000, Rs. 2000, Rs. 3000, Rs. 4000 and Rs. 5000 per month at the age 60 and employees can opt to join any of these.

iii) Opt out option

All employees have to automatically enroll their eligible workers, unless the employee opts out.

VI Linking Insurance with Pension

20. Pension is a long term engagement and keeping in view the income profile of the targeted group, it is proposed to use insurance and health coverage as an incentive for long term engagement. Insurance components like insurance coverage of health and life may be bundled with APY to take care of health and life contingencies of the members.

Health Insurance: Rashtriya Swastha Bima Yojana (RSBY), specially launched for unorganised worker falling under BPL category and latter extended to other categories of workers like Building and other construction workers registered with the Welfare Boards, Licensed Railway Porters, Street Vendors, MNREGA workers who have worked for more than 15 days during the preceding financial year, Beedi Workers, Domestic Workers, Sanitation Workers, Mine Workers, Rickshaw pullers, may also be extended to the members who will auto enroll under APY scheme for a monthly pension of Rs. 1000/- so that the health insurance benefit is restricted to the poorer section of society.

The beneficiaries under RSBY are entitled to hospitalization coverage up to Rs. 30,000/- per annum on family floater basis, for most of the diseases that require hospitalization. The benefit will be available under the defined diseases in the package list. The government has framed indicative package rates for the hospitals for a large number of interventions. Pre- existing conditions are covered from day one and there is no age limit. The coverage extends to maximum five members of the family which includes the head of household, spouse and up to three dependents. Additionally, transport expenses of Rs. 100/- per hospitalization are paid to the beneficiary subject to a maximum of Rs. 1000/- per year per family. The beneficiaries need to pay only Rs. 30/- as registration fee for a year while Central and State Government pays the premium as per their sharing ratio to the insurer selected by the State Government on the basis of a competitive bidding. The scheme will provide cashless benefits to the auto enrolled APY members in the empanelled hospitals.

Dsability insurance: Life insurance element and insurance against total/partial disability as provided under Pradhan Mantri Suraksha Bima Yojana (PMSBY) may also be clubbed with the APY auto enrolment. PMSBY covers the risk against accidental death and permanent total disability for Rs.2 Lakh, and permanent partial disability for Rs.1 lakh at a premium of Rs.12 per year. The Scheme is available to people in the age group 18 to 70 years with a savings bank account to enable auto-debit on annual basis which can be renewed periodically. The risk cover is offered by public sector general insurance companies or any other general insurance companies offering the product. The premium of Rs. 12 per annum will be paid by the beneficiaries from their saving account.

VII. Benefits of auto enrolment pension

21. The Automatic enrolment with health and insurance cover under Atal Pension Yojana is expected to enhance the coverage particularly in the unorganized sector and help in saving for their retirement while they are earning. As employer contribution is voluntary, an affirmative action, there may not be much resistance to this change.

22. The employers may be extended the same tax rebate for the contributions made towards the pension account of their employees/ workers as available under NPS for employers. While claiming tax rebate, the employer will have to submit documentary evidence for having contributed to the pension account of the employee/ workers. The maximum number of workers for which one can claim such rebate may be kept at 19, as 20 and above are already covered under the EPF and MP Act. All Micro and Small industires, panchayats, anganwadis etc. will be under obligation to promote this scheme, and help in registration of their underlying workers/ members.

VIII. Being automatically enrolled back into auto enrolment pension

23. If a worker stops paying into the auto enrolled APY account for some months, the existing provisions of APY will be applicable.

IX. Phase wise implementation of auto enrolment

24. The implementation of auto enrolment under APY will be accompanied by an extensive awareness and publicity campaign by the Central/State Governments involved with the implementation of social welfare programmes / schemes under which the targeted groups of employees/workers fall .

X. Monitoring and compliance

25. Employers will provide disclosures to the regulators (PFRDA and Tax authorities and to their own employers) in their declaration about voluntary compliance on annual basis. Employers will be required to maintain records showing contributions made by them/employees.

XI. Government Notification

26. The Central Government will have to issue a notification to adopt Auto Enrolment for APY in select segments of the informal sector.

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Note:

Comments may be offered vide e-mail on **alpana.vats@pfrda.org.in** or in hard copy to the below address by 7th October 2016:

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