

Pension Reforms in India

4th Global Conference of
Actuaries

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Agenda

- Background & Current Framework
- Basic Issues
- Reform Initiatives
- Reform Initiatives in the private sector

Background

- Strong Joint family concept
 - With the Patriarch as the pivot provided Old Age Security
 - Was adequate in a agrarian & rural society
 - Industrialization and urbanization undermined the traditional concept
 - Even if prevalent effectiveness as an old age security tool is doubtful

Old age Security Plans

- Civil Service Schemes
 - Government at Centre and the state assured pension to their employees
 - Pension is non-contributory, indexed, Defined Benefit & totally unfunded and paid on PAYG
 - Provident Fund contributed by employees
 - Most of the Quasi Government institutions have adopted the similar schemes

Old age Security Plans

- Mandated Industry Schemes
 - Provident Fund Scheme mandated by a central legislation across the country
 - Provides for contributory Provident Fund
 - Pension towards which a part of the Provident Fund Contributions are diverted
 - Gratuity Scheme again mandated by a central legislation
 - Lumpsum payment based on last drawn wages at the termination of employment after a five years of continuous service

Old age Security Plans

- Voluntary Industry Schemes
 - Superannuation Plans introduced by employers voluntarily
 - Predominantly introduced by Corporates and DB
 - Either administered by the Trustees or by LIC
- Other Old age security schemes introduced by the Governments
 - Governments at the state as well as at the centre have introduced a few schemes

Coverage

- Estimated working population is about 350 million
 - 15% of which is salaried employees (of which Government 23% & Non-Government 49%)
 - 53% are self employed
 - 31% are Casual contract workers
- Only the salaried employees are covered by any kind of pension plans
 - 28% of such salaried employees are also not covered.
- Effectively this means hardly 10% of the working population is covered.
- As a percentage of population it is a miniscule 3%

Basic Issues

Pension Crises

- Civil Service Pensions
 - Central Govt Pension liability is 15% of the net tax revenue as on 2000-01
 - Combined with State pensions the pension liability accounts for 2.25% of the GDP
- Demographics
 - Expected population increase between 1991 and 2016 is 49%
 - The elderly persons (60 and above) would increase by 107%
 - By 2026 elderly persons would constitute 14% of the population

Other basic issues

- Regulatory Framework
 - There are a number of legislations & authorities that govern Pension plans
 - Employee PF is over regulated but under supervised
 - Voluntary Employer Pension schemes are not governed at all
- Philosophy of regulation
 - Explicit framework or implicit framework
- Type of Benefit
 - Defined Benefit or Defined contribution
- Tax regime
 - Currently Voluntary Superannuation plans are EET while PF and gratuity are to a large extent EEE.

Other basic issues

- Accumulation issues
 - Funding to be made mandatory
 - Currently Civil service pension is totally unfunded
 - Pension part of Employee PF may not be adequately funded
 - Gratuity is most of the time unfunded
 - Asset segregation
 - Voluntary SA and Gratuity Trusts are required to be run as irrevocable trusts
 - EPFO and LIC pool the corporate pension assets

Other basic issues

- Design Issues
 - Vesting
 - No statutory norms
 - On voluntary pension plans it is defined by the employer, sometime excessively harsh against employees
 - Eligibility
 - Portability
 - Indexation
 - Access to corpus

Other basic issues

- Payout Issues
 - Method
 - Lump sum Vs Annuity
 - Source
 - Lump sums are paid by Trusts, annuities need to be purchased from Insurance company
 - Insurance & Guarantee
 - Should Pensions be guaranteed on the lines of PBGC?
 - Prudent underwriting and Valuation

Other basic issues

- Industry Issues
 - Authorization criteria
 - Administrators, Fund Managers, Trustees, Actuaries
 - Expense ratios
 - On voluntary schemes employer has to bear all costs
 - No transparency on costs charged by EPFO; Employer needs to bear the same.
 - Prudent norms needs to be evolved

Other basic issues

- Investments
 - Explicit frame work or Prudent Person
- Information Disclosure/ Audit/ Supervision
 - Norms for information disclosure, Accounting conventions, etc.
 - Supervision and regulatory metrics could be made transparent and enforced vigorously

Reforms

- OASIS Committee – the first effort
 - Recommended the Chilean model for covering unorganised sector
 - Utilising the vast network of Public Sector Banks and Post Offices
 - With individual choice on investments and FMs
 - Well intended but is it practical?

Reforms

- Budget 2001 – Beginning of serious efforts
 - Committee set up to suggest road map on Civil Service Pension
 - IRDA to suggest road map on coverage
 - Both reports are with the Government
 - Budget 2002 to be announcing the next steps.
- EPFO – BPR aimed at reinventing itself

Reforms

- Private Sector initiatives influenced by
 - Labour Mobility
 - Change in Concept of Salary
 - Taxability of Salary
 - Interest rate regime
 - Crystallisation of liability
- Resulted in shifts from DB pension plans to DC

Reforms - Objectives

- One single codified comprehensive legislative and infrastructure framework that provides for
 - Coverage of all sections of the population
 - Optimally funded pension plans
 - Provides for employer level/industry level freedom on pension administration
 - Effective individual choice in investments and payout options
 - Unified regulatory authority for the plans and the players

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