Pension Reforms in India

4th Global Conference of Actuaries

15th February 2002

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
  - Crystalisation 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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