‘Pension assets to be Rs 1500 bn by 2010’

The Union Budget for 2009-10 has brought back the limelight on the New Pension System (NPS) introduced by the Central government on 01 January 2004 and extended to all on a voluntary basis from 1 May 2009. To know more about the pension fund market and the scope of the NPS, *Capital Market* spoke to LIC Pension Fund, CEO **Dr. H. Sadhak.** Excerpts from the interview:

DR. H. SADHAK
CEO,
LIC Pension Fund

How did the New Pension Scheme (NPS) evolve?

The current social security and pension, which exists mainly for the organised sector, covers only 11% of workers. The only formal social security and pension coverage was the civil services pension, which covered employees of the Central and state governments and provided defined benefit pension, which was critically unsustainable as the annual pension payment was increasing steadily. This increasing pension fund cost put a tremendous pressure on government finances. To address all this, the Central government launched the NPS, a defined contribution system for employees of the Central government who joined services on or after 1 April 2004.

How does the NPS work?

The NPS introduced in India is a self-financed two-tier system. Tier 1 is contributory, tax deferred system under which employees contribute 10% of her/his salary and a matching contribution is made by the employer, while Tier 2 is a voluntary saving scheme.

The pension system has two phases, i.e., accumulation and decumulation. To manage the fund under the accumulation phase, LIC, SBI and UTI were selected by the Pension Fund Regulatory and Development Authority (PFRDA). LIC Pension Fund was the first pension fund company incorporated in November 2007 as public company to manage pension fund approved by the NPS Trust.

Do we have a developed annuity market to support the structure of payout from Tier I investment?

The NPS follows the mandatory annutisation under the decumulation phase. Any member can exit from the NPS at the age of 60 years. However, the member has to mandatorily spend at least 40% of his or her pension wealth to purchase an annuity from a life insurance company approved by the Insurance Regulatory and Development Authority.

Effective implementation of mandatory annutisation depends on a vibrant and dynamic life insurance sector to supply appropriate annuity products. Annutisation will also need support of a debt market to facilitate long-term investment of pension assets like long-term inflation-linked bonds.

What kind of investment strategy does LIC Pension Fund follow?

The LIC Pension Fund invests 85% in Central and state government and PSU bonds, 5% in equity and 10% in equity-related mutual funds or corporate debt.

The Public Provident Fund is under the exempt-exempt-exempt tax regime, while the NPS carries the exempt-exempt-taxed method of tax treatment. How will this affect the growth of the NPS?

We understand that the PFRDA is making efforts for that.

Foreign direct investment in the NPS is limited to 26%. What kind of roadmap do you see for foreign investment in pension funds?

There is a possibility of increasing the foreign investment limit in the sector from the current level of 26%. But this will totally depend on the government. The current level is good to start with.

Why has the NPS not attracted consumers despite its special features?

The awareness about pure retirement savings in India is quite low. While there is a significant increase in household savings in mutual funds, stock markets and life insurance, there is a noticeable decline in household savings in provident funds. It is, therefore, necesssary to strengthen the institutional mechanism to spread financial literacy and awareness of retirement investment.

What is the share of pension funds in India’s total savings?

The Indian pension market is still very small: it was only 5.3% in 2005 in terms of GDP when compared with other countries with similar GDP to pension assets. Household savings through provident and pension fund have declined from 22.2% in 1999-00 to 9.2% in 2006-07.

Chile’s pension funds account for 65% of the GDP, while Singapore's 63%, and South Africa's 40%. In developed countries, the Netherlands' account for 125% of the GDP and Ireland's 123%.

According to a study conducted by FICCI–KPMG, pension assets in India after reforms would increase to Rs 4,064 billion (US$ 83.8 billion) in 2025. Another estimate of Helen K Poirson of the IMF shows that pension assets would grow from Rs 1500 billion in 2010 to Rs 3000 billion in 2020 and further to Rs 4000 billion in 2025.

Are the steps taken in the recent budget enough for the development of the NPS?

As a pension fund manger, the abolition of the securities transaction tax will act as savings from here onwards, while the abolition of the dividend distribution tax will help to increase the quantum of dividend. The effects of these steps will be felt over a period of time. ■

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