Pension Plans for a Better Tomorrow

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***Abstract*: To ensure that we live our retired life comfortably, the way we are living today, it's important that we plan our financial goals prudently during our working life. That's the key to a happy retired life. Planning for retirement is a crucial aspect of everybody's lives. Considering the rising inflation level and limited social security initiatives for senior citizens, it is vital to start for retirement early. As people develop through their lifetime they have an expectation that a time will come when they will be able to retire. For some people the State pension is sufficient to provide a basic level of income. Others may have an opportunity to accumulate wealth without using pension schemes - perhaps through their business ventures or other assets. But most people will want to supplement what they have with some form of pension scheme. Many employers also take the view that, while their employees are working, they should be building up an entitlement to a pension when they retire.This paper provides an overview of a pension and its importance.**

Keywords: Pension Schemes, Retirement, Planning.

INTRODUCTION

Pension is very important for senior citizens to maintain and improve their quality of life, through greater independence in their decisions, improved status in the family and greater self-confidence.

When people do not enjoy a regular and steady source of income, it becomes more significant to have a pension plan handy. A standard retirement plan serves to ensure that individuals can sustain their life standards without being dependent on others and without having to compromise on their standard of life during their post retirement period.

Government has the sole responsibility to formulate and implement public policy on population ageing. The majority of working population in India expects to have better quality of life at least to maintain the current living standards after retirement. This is the prime reason why pension plans today account for around 39 per cent of insurance industry's total business.

In the Constitution of India, entry 24 in list III of schedule VII deals with the "Welfare of Labor, including conditions of work, provident funds, liability for workmen's compensation, old age pension and maternity benefits. In Directive Principles, Article 41 of the Constitution of India directs the State to provide public assistance to its citizens in case of unemployment, old age, sickness and disablement and in other cases of underserved want within the limit of its economic capacity and development.

Meaning and Importance of pension

A pension is a contract for a fixed sum to be paid regularly to a person, typically following retirement from service. As people grow through their lifetime they have an expectation that a time will come when they will be able to retire. For some people the State pension is sufficient to provide a basic level of income. Others may have an opportunity to accumulate wealth without using pension schemes - perhaps through their business ventures or other assets. But most people will want to supplement what they have with some form of pension scheme. Many employers also take the view that, while their employees are working, they should be building up an entitlement to a pension when they retire.

Pension arrangements have a number of advantages:

a) When people come to retire they will experience a reduction in income - a pension makes up for some of this loss of income in retirement;

b) Pension schemes can provide protection in the form of lump sums and pensions to dependents in the event of a member's death;

c) In order to encourage pension schemes, the State provides tax relief on contributions made to pension schemes and the growth in their investments.

Pension systems address longevity and inflation risks in various ways. For the most part, the richer OECD countries tend to rely on social insurance programs to address longevity risk and to address the inflation risk, some countries apply price or wage indexation to pensions, while others rely on ad hoc increases in nominal pension benefits. In India, most people do not benefit from nor are they covered by pension (and healthcare) benefits on a universal basis. Typically, only the armed forces, civil servants, and some private sector employees have access to pensions. As a result, longevity and inflation risks are mitigated only for a small proportion of the labor force.

Longer life expectancy, falling stock market returns and paltry annuity rates are causing growing concern for people looking forward to an active and fun-filled retirement. A report from The Association of Consulting Actuaries (ACA) concludes that many people need to increase their pension contributions to ensure that they will have enough to live on. ACA focused on money purchase schemes, which are becoming the most popular type of scheme offered by employers. Its report concludes that someone in their mid-30s needs to save 15-20 per cent of their annual salary into a money purchase pension to get a retirement income of around 60 per cent of their salary. For people aged 40, the figure rises to 17-25 per cent, and for those who are 45 when they first take out a pension, they need to save 23-30 per cent of their annual salary.

Role of pension in older peoples' social security

As people develop through their lifetime they have an expectation that a time will come when they will be able to retire. For some people the State pension is sufficient to provide a basic level of income. Others may have an opportunity to accumulate wealth without using pension schemes - perhaps through their business ventures or other assets. But most people will want to supplement what they have with some form of pension scheme. Many employers also take the view that, while their employees are working, they should be building up an entitlement to a pension when they retire.

There has been a demand for a Policy Statement by the State towards its senior citizens so that they do not face an identity crisis and know where they stand in the overall national perspective. The need has been expressed at different forums where ageing issues have been deliberated. The Statement, by indicating the principles underlying the policy, the directions, the needs that will be addressed and the relative roles of government is expected to facilitate carving out of respective areas of operation and action in the direction of a human age integrated society

CURRENT PENSION PLANS IN INDIA

Civil Servants' Pension (CSP):

CSP is a traditional defined benefit scheme which runs on the basis of pay-as-you-go system, for employees of Central Government who were recruited up to 31st December, 2003 and employees of State Governments recruited up to the effective date mentioned in notifications issued by those governments. There has been no attempt at building up pension assets through contribution or any other provision in CPS. CSP scheme is indexed to wages and inflation. A modified one rank one-wage principle applies to it wherein all retired employees of a certain rank get the same pension. Pension payments are revised periodically to reflect the growth in wages and consumer price index. Growth in pension benefits in old age is typically higher than inflation.

Employees Provident Fund (EPF):

The EPF Scheme is an individual account defined contribution scheme wherein both the employee and employer contribute to the fund at the rate of 12 per cent of the employee's pay. There are a number of provisions under the scheme for pre-mature withdrawal of accumulation. This pre-mature withdrawal provision is frequently used by the members of the scheme which leads to small balances at the time of their superannuation. Because of low balance in individual account of the members, old age income benefit is negligible. The EPF scheme enjoys an Exempt Exempt Tax (EET) structure which constitutes a major tax based subsidy.

Employees' Pension Scheme (EPS): The EPS is a defined benefit scheme, based on a contribution rate of 8.33 per cent from the employee to which government makes an additional contribution of 1.16 per cent. EPS was introduced in 1995 and is applicable to the workers who entered into employment after 1995. In case of death of a member the scheme provides for a pension to the spouse for his/her remaining life.

There are other voluntary pension schemes available for general public but these schemes cover a very small segment of the total population. Life Insurance Companies and Mutual funds are offering these plans. These are essentially defined contribution schemes. Personal Pension Plans and Group Pension Products offered by the life insurers are being supervised by the Insurance Regulatory and Development Authority (IRDA). Schemes offered by the Mutual Funds are regulated/supervised by the Security Exchange Board of India (SEBI). Tax benefits up to a specific amount are being offered to investors buying these pension plans. Total coverage under these pension plans is about 1.6 million.

The other popular scheme is Public Provident Fund (PPF) which is also a defined contribution scheme. Government is managing this scheme. A fixed rate of return is offered under the scheme. In addition, tax benefits are being offered for making investment in the Public Provident Fund account. Coverage under the Public Provident Fund is about 3.5 million.

In 2001, Government of India appointed a group of experts to study the various aspects of extending an organized system of pension to the unorganized sector. The group submitted its report in October 2001. According to this report, the pension market (which includes pensions, provident funds and other small savings i.e. National Saving Certificate (NSC), National Service Scheme (NSS)) would grow to about Rs.4064 billion by 2025. The growth would largely be due to normal growth of economy in terms of growth in income and population and does not consider the significant increase in coverage that would arise because of reforms in the insurance and pension sectors. A more conservative estimate is that the pension market will be worth about Rs.1808 billion by 2025.

NATIONAL PENSION SCHEME (NPS)

The National Pension Scheme introduced by the Government of India is South Asia's first Defined Contribution (DC) pension scheme with individual retirement accounts, product choices, professional fund management by competing fund managers and portability through centralized record keeping and administration. The NPS is an attempt to move away from the defined benefit pension plans to defined contribution based schemes. But, this change would be applicable only to the new entrants. The idea behind pension plan is to provide financial security and stability to individuals during the later stages in life. It is applicable to all Central Government Employees who joined on or after 01–01–2004. Under the NPS, every subscriber will have an individual pension account, which will be portable across job changes. The subscribers can choose fund managers and schemes to manage their pension wealth. They may also have the option of switching schemes and fund managers. NPS has been extended to all citizens of India with effect from 1st May 2009. Tamil Nadu state is the first state to introduce (6.8.2003) the contributory pension system in India. This research explores some of the unanswered important questions about national pension system that can be examined and investigated. It also explains the factors responsible for the unusual movements in net asset value, which could not be fully explained by the theories of traditional finance. This study examines their important attitudes displayed by the pension subscribers in new pension system. They are: 'financial literacy' towards national pension system'; 'Expectations' those subscribers have about the future performance of the net asset value in national pension scheme in India; 'expected rate of return' that pension subscribers have regarding their pension investments; and 'Satisfaction level'. Present study also analyses the pension investors' preference towards national pension system.

NPS DEVELOPMENT

Pension Fund Regulatory and Development Authority (PFRDA) has taken a step-by-step approach to introduce various pension schemes. In the first phase, new pension scheme for central government and central autonomous organizations' employees were introduced with effect from 1st January 2004. Pension contributions of all such employees were kept in a separate account under the Public Accounts of India and funds management began with effect from 1 st April 2008. Simultaneously, NPS was also extended to all the employees of state government/union territories and state/union territories' autonomous organizations. In the meantime PFRDA developed.

The necessary funds management infrastructure including appointment of Central Record Keeping Agency (CRA), three Pension Fund Managers (PFM) namely, LIC Pension Fund Ltd, SBI Pension Fund Ltd and UTI Retirement Solutions Ltd, and NPS Trustee, NPS Trustee Bank and Custodian. Three PFMs started investing NPS funds of central government employees with effect from 1 st April 2008. In the second phase, PFRDA extended the NPS to all citizens in India through All Citizens Scheme launched with effect from 1stMay 2009. PFRDA appointed six PFMs and Point of Presence (POP) to manage funds for the all citizens scheme.

In the third phase, the PFRDA introduced the Tier-II NPS for all accounts holders under Tier-I, that is, members of central government/state government/union territories and central/state/union territories' autonomous organizations' employees. Tier-II was opened for subscription with effect from 1stDecember 2009. In the fourth phase PFRDA introduced NPS Lite Scheme on 22nd July 2010. This was a welcome strategy for a new system and past experience helped to modify earlier weaknesses of implementation. A separate scheme has also been introduced for the corporate sector employees. Following the implementation of NPS by the central government for its employees, the state governments in India also decided to implement NPS for its employees but effective dates were not the same? Implementation dates in some states were even before January 2004; for example, the state of Tamil Nadu implemented NPS with effect from November 2003.3 Tamil Nadu state became the first state to implement NPS for its newly appointed employees from the financial year 2003-04.

The year 2013 was an important year for the National Pension Scheme (NPS). After ten years, the Pension Fund Regulatory and Development Authority (PFRDA) Bill was finally cleared in Parliament in September 2013. With the passage of the bill, PFRDA, which until recently was working through an executive order of the government, got regulatory powers to run NPS

THE SALIENT FEATURES OF THE NATIONAL PENSION SCHEME (NPS)

A Flexible System NPS is quite flexible as it is not mandatory for all workers but for the new employees of the central government who joined after a specified date, that is, 1st January 2004 and also it is voluntary for other workers. Also it is mandatory for the new employees of the state government, who have joined NPS. For the state government employees effective date is not 1st January 2004 but the date at which the states have joined the NPS or the effective dates decided by the state governments.

NPS is a combination of four schemes The NPS at present comprises four schemes aimed at covering different segments of workers / citizens. These are:

- NPS for central and state government employees: Participation in NPS is mandatory for central government employees (excluding armed forces). Participation is also mandatory for state government employees in the states which have joined NPS.
- NPS for all citizens (unorganized sector): it is a volunteer scheme open to all citizens of India.
- NPS for corporate sector: This is voluntary scheme specially designed for employees of the corporate sector.
- NPS Lite: NPS Lite is a unique scheme designed for vulnerable section of society and participation is voluntary for all citizens in India.

Individual pension account NPS is an individual account-based pension scheme. Every subscriber is issued a unique Permanent Retirement Account Number (PRAN) by the Central Record keeping Agency (CRA). Through this PRAN, a subscriber can periodically accrete saving into her/his individual account. This account is portable and remains with the member even whenever the member changes employer or location.

Portable Pension Account The new pension system is a portable scheme and the members have the option to transfer individual pension accounts in case of change of employment or change on location anywhere within India. This is definitely an important feature of the NPS, as there are frequent job switching from government/ public sector to private sector and also from one employer to another.

Switching facilities The NPS allows the subscribers to switch over from one fund manager to another and from one scheme to another.

Two-Tier system The NPS is a fully funded Defined Contribution (DC) pension system based on individual account, individual contribution and active investment choice. It is a two-tier system. Tier- I is a non withdraw able and tax deferred pension account, which resembles the second pillar in three pillar system. It is mandatory for central government employees but voluntary for All citizens scheme and Corporate scheme while the Tier-II is a voluntary savings plan and a member is free to withdraw part of all of the Tier-II wealth anytime. Tier-II is managed through exactly the same way as the assets of Tier-I. This withdraw able account does not constitute pension investment, and there are no special tax incentives, while the Tier-I account was made available from May 1 2009; the facility of Tier-II account was available with effect from 1 st December 2009 to all citizens of India and government employees mandatorily covered by NPS. The Tier-I is a pension account while Tier-II savings account serve the members to mitigate two different financial needs long-term retirement income and short-term financial requirement, though a member can maintain the Tier-II account till she/he exits from the scheme. While the members of Tier-I are eligible for tax incentives, there is no such incentives for investing in Tier-II as it is a withdrawal account which allows the investors to withdraw from this account on account of emergency financial contingencies.

The Tier-II account is available to those investors who are members of NPS through Tier-I. Therefore an active Tier-I is a pre-requisite for opening a Tier-II account. Some important features of Tier-II account are that there are no limits on number of withdrawals. There are no additional CRA charges for opening a Tier-II account and annual maintenance, but separate transaction charges are levied by CRA for each transaction.

Conclusion

In this scenario pension is the most important source of social security for the retired old people. The Constitution of India has recognized the pension as one of the social security measures. The Supreme Court of India has given the judgment that pension is the fundamental right of the employees. The Government of India introduced the New Pension Scheme from 1.1.2004 as a defined contribution system. Through the NPS the burden of providing social security has been shifted from the Government to the individual concerned. There are several flaws in the system. To cite an example, the contribution to be invested in stock market has a huge bearing and has created apprehension among the employees. There is no certainty with regard to the amount of pension to be received at the time of retirement in NPS.

The study shows that maximum of the respondents opine that 100 per cent social security is not possible through NPS as promised. They also feel that a minimum amount of pension must be guaranteed by the Government. Majority of the respondents opine that the pension contribution should not be invested in stock market as they think that it is very risky. Even though the study shows that the employees are aware of the fundamental aspects of NPS the financial literacy level of majority of the respondents is low; therefore more awareness has to be created among the employees relating to NPS.

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