FOR PUBLIC AND STAKEHOLDERS COMMENTS –

CONCEPT PAPER- CHOICE TO THE GOVT EMPLOYEES

A. Launch of NPS and Current scenario

1. The National Pension System (NPS) was introduced in 2003 for all Central Government employees (except armed forces) who joined the service on or after 01.01.2004. The NPS marked a paradigm shift from the Defined Benefit Pension Scheme to Defined Contribution Scheme, thereby easing the escalating fiscal stress on the Government on account of rising pension liabilities. In 2009 different Schemes under the flagship of National Pension System were launched under the private sector and unorganised sector.

2. The National Pension System (NPS) has been arguably hailed as one of the best designed pension products domestically with its several unique features like full portability across jobs and geographical jurisdictions, choice of investment options to suit different risk appetites, option to choose from among several fund managers, no entry or exit loads, and perhaps the lowest fund management charges in the world. It is also regulated by a dedicated regulator.

3. The passage of the PFRDA Act in September 2013 followed by notification of the Act on 1st February 2014 marks an important milestone in the history of the Pension Sector reforms as the Act provides an overarching mandate to the PFRDA for promotion and development of old age security in India. In light of the paradigm shift in the pension landscape in the country, it is imperative to review the progress of NPS so far and realign the existing policy framework for Pension Funds within the mandate of the Act.

4. The NPS adopted a direct selling model to keep the costs low and to avoid the urge to mis-sell due to the embedded commissions. This distributor-free and agent-free model was designed to protect the individual and to maximise the pension wealth. It was adopted even at the risk of a slow start. The NPS architecture has been designed to create an enabling environment for the citizens to save for retirement.

5. Additionally, NPS also provides flexibility to subscribers where they can switch their pension funds among three options, i.e. equity, corporate bonds and government securities. They can also change their fund managers if they are not satisfied with the performance of Pension Funds.

B. Need of Revamping

- It is more than 12 years under NPS Govt. Sector and 6 (six) year since NPS was introduced in the market to cater to the retirement needs of Private Sector/Unorganised Sector subscribers.
- The NPS has made noticeable progress from the time of its inception, on boarding about 1 Crore subscribers with a total AUM exceeding 100000 crores by Dec 2015, with only 12% of the workforce covered by any kind of old age security in India, there is thus a huge untapped potential for NPS to expand. However, this would require multipronged approach with co-operation of multiple stakeholders including Central Government, State Governments, Autonomous bodies, trade bodies, Regulators and many more.

- Besides the expansion in coverage, the provision of old age income security also entails working towards adequacy of income post working life, which can be done by optimizing returns through appropriate investment guidelines. While devising the investment guidelines, the interest of the subscriber is to be kept paramount, balancing the security aspect with adequacy of returns. While returns on investment under DC scheme cannot be guaranteed, it is important to frame guidelines, which enable the pension funds to deliver good real rate of returns to the subscriber for meaningful old age income security, which cannot be done with overload of fixed income securities. Hence, an enabling environment is required to be created for the Subscriber to maximize his/her returns depending upon his/her risk appetite.

- The fiscal stimulus being provided by the Government each year through its budget announcements are a major boost to the NPS , propelling the built up of a pensioned society.

- The experience gained since last more than decade this has been quite obvious that the NPS system has a well laid out architecture, it has been able to draw enough attention from the individual subscribers by very little marketing and publicity. It is also perceptible that investor awareness towards the various financial products has grown to the extant where subscribers can decide about the mix of asset class and Pension Fund and change the same as per its discretion.

C. NPS FOR GOVT. SECTOR EMPLOYEES

1. Earlier Government, the pension funds of the Central Government employees are currently being allocated amongst the three public sector pension funds (UTI PFM, SBI PFM, LIC PFM) in the ratio of their returns. The investment pattern for the Central Govt. employees is also stipulated by the Government, having a preponderance of fixed income securities, which can currently go upto 95% while the maximum exposure in Equities is restricted to 15%

2. In the early stages of the movement from Defined Benefit to Defined Contribution, what propelled the Govt to make these choices was, perhaps, the over-riding concerns towards shielding the savings of beneficiaries from volatility and risk, and protecting it from capital erosion. These anxieties seem justified and essential for the development of NPS in its nascent stages. The Directed Investment regime was also in keeping with the low financial literacy levels in the country and underdeveloped financial and nascent regulatory environment in the pension sector at that time.

1. CHOICE TO THE GOVT EMPLOYEES

Reasoning: Key reasons to claim choice to the Govt. employee from are -

1. **<u>Shift in risk from employer to employee</u>**: It cannot be over emphasised that the movement from DB scheme to NPS marks a shift in onus of funding the old age income security from the employer to the individual employee, through his/her individual retirement accounts.
2. **<u>Mandate under PFRDA Act 2013</u>**: It is in this back ground that the PFRDA Act provides for opportunities to the subscriber to maximise his returns in the <u>risk return paradigm</u>. Section 20(2) of PFRDA Act, 2013, states that *there shall be a choice of multiple pension funds and multiple schemes.* Hence, post the notification of the PFRDA Act, there is need to align the investment framework for the Govt employees including Central Govt employees.

3. **<u>Parity with other subscribers</u>**: The subscribers under the private sector are already **<u>enjoying</u> a choice in the selection of Pension Fund Manager(both public and private sector PF) as well as the choice to allocate funds amongst the three asset classes (Equity(E), Corporate Debt (C) and G (Govt securities) with only ceiling of 50% on equity.** On the other hand, the investment pattern

for the Central Govt employees prescribes preponderance of fixed income securities, which can currently go upto 95% while the maximum exposure in equities is restricted to 15%, effectively limiting subscriber choice.

4. **Recommendations of the Bajpai Committee report (2015)** : The recently released report of the Bajpai Committee has also recommended the opening of the choice of pension funds and allowing same investment pattern as permitted to the private sector employees.

   a) **Choice of the pension funds**

1. The current process restrict the deployment of funds of the Central Govt. employees across the three Public Sector PFs only. In the first place, this prevents the employees to choose a pension fund(even amongst public sector PFs as they are restricted to a combination of three Public sector PFs) Secondly ,this dispensation disallows them to tap the expertise of the Private sector pension Funds. Not only is this discriminatory on the grounds of equity, this also militates against the spirit of the PFRDA Act which provides for choice of the Pension fund under section 20(2).

2. It may not be out of place to mention that the PFRDA Act further provide for at least one public sector Pension fund. Hence, those Govt sector employees always have the option of choosing a public sector Pension Fund. However, this has to be the conscious decision of the employee, based on his perception of the performance of the Pension Fund, rather than a mandate by the employer.

3. The opening of choice of Pension funds to the Central Government employees will not only benefit the employees but also galvanise the pension sector in more ways than one. It would create competition amongst the pension funds, both public sector and private sector- to vie for the pension corpus. Enhanced size of the market will also attract more players in Fund Management space leading to greater specialization, risk diversification, risk management and enhanced governance standards and better performance across the industry. The concomitant result would be increased efficiency in both pricing & servicing and higher levels of subscriber satisfaction. Hence, for the benefit of subscribers and development of the pension sector as a whole, it would be desirable to allow market forces to determine the size of the pension corpus managed by a pension fund rather than through a mandated / directed regime. This has also been recommended by the Bajpai committee as stated below.

The restriction of allowing Pension funds only from the public sector to manage the funds of Government employee subscribers may be done away with. This will also be in keeping with the mandate under the PFRDA Act to provide choice to the subscriber. On the other hand, the enhanced competition and the appurtenant economies of scale shall go a long way in building a healthy pension corpus for the subscriber."

4. However, as approved by the Board, the default option for central Govt employees could continue be the combination of three Public sector Pension Funds as hitherto. Subsequently, this could be moved to one pension fund from the public sector and finally to any pension fund, selected as default Pension Fund.

b) **Choice of investment pattern**

1. The existing investment pattern prescribed for the Govt employees is broadly based on the guidelines stipulated by the Govt from time to time. Currently, the guidelines for the Govt sector are being revised broadly based on the Govt OM no 11/14/2013-PR dated 7th April 2015. The Govt. guidelines stipulate investment of minimum 80% in fixed income securities- Govt securities and corporate bonds- which can go upto 95%.Investment in equity has been mandated between 5 to 15%.

2. As per the Bajpai Committee report (2015),

" *The design of the mandated investment norms in vogue today with predominance of low risk fixed income securities, that too mainly Government securities, has lower tolerance for risk, but a high tolerance level for lower returns especially in case of the Government Sector employees. This is, in the opinion of this Committee, unfair for the investors who may need a combination of low risk with moderate returns or even higher returns with higher risks. This is especially true for those in the early stages of their saving curve. There can be no denying that in the pursuit of risk-free investment, investors are getting the short shrift and are therefore revealing a preference for physical assets*."

3. On the other hand, guidelines for the private sector allows the subscribers to allocate their contribution across the three asset classes – Equity, Corporate bonds and Govt securities with only restriction of investment in equity upto 50% . Thus, on the grounds of parity, and keeping in view the spirit of the PFRDA act to allow choice of schemes, it is essential to revisit the framework for investment by the

Central Government employees and allow them choice of investment as available to the Private Sector employees.

4. This has also been recommended by the Bajpai Committee (2015) as under:-
“Multiplicity of investment mandates across various Regulatory Regimes within the domain of pension sector creates an uneven playing field and therefore there is an urgent need to harmonise the same. The existing investment norms across all regulatory regimes be harmonised, at least till such time as the move to a prudent investor regime is complete. This creation of a harmonised regime will usher in transparency and allow investors to compare their returns across product platforms. A beginning can be made by harmonizing the investment guidelines within NPS across Government and Private Sector i.e. loosening the guidelines for Govt sector to allow more play to the Pension Fund managers in asset classes like equity, which are historically known to beat inflation across various countries in the long run.

5. It is also pertinent to mention that the capital market has also been evolving rapidly with new instruments being offered and the opportunities for investors growing. With the shift of burden of funding the retirement income resting on the employee, it is important to create a facilitating environment to enable him to plan his retirement judiciously through prudent investments based on his risk appetite.

6. The opening of the Govt sector, which comprises the majority of the AUM of the NPS, will have cascading impact on the development of the capital market, and the development of the economy as a whole. A step in this direction has already been taken by the Govt by mandating minimum 5% investments in the equity in its OM no 11/14/2013-PR dated 7th April 2015. Harmonisation of the investment guidelines between private and Govt sector will also pave way towards a more unified pension regime in the country.

The opening of the choice to the Central Govt employees would be a first step in opening the choice to all the NPS subscribers as under:-

a) Choice of Pension Funds across all pension funds to all the subscribers under NPS including Govt Sector employees (APY is a DB cum DC scheme and hence will be out of the purview)

b) Choice of investment pattern (Choice of equity , Debt and Govt Securities) across all pension funds to all the subscribers under NPS including Govt sector employees . (APY is a DB cum DC scheme and hence will be out of the purview)

Note: Comments may be offered vide e-mail on sumeet.kapoor@pfrda.org.in or in hard copy to the below address-

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