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Secure your Future with the New Pension System

By : INVC Team Published On : 14 May, 2009 10:37 AM IST

Manish Desai** May Day 2009 marks a watershed in employee welfare, with the launch of the New Pension System. A first step has been taken towards finding sustainable solution to the problem of providing adequate retirement income for millions of workers and other employees. Initially, the Pension Fund Regulatory Development Authority (PFRDA) has operationalized the Tier I of NPS constituting non-withdrawable pension account. The Tier-II of NPS, comprising withdrawable account, will be launched six months later. The New Pension Scheme is voluntary and any citizen of India can participate in it. To open a pension account, you have to approach the branches of any of the 22 Points of Presence (POP) service providers selected by PFRDA. POP service providers include leading banks like LIC of India, State Bank and its associates, ICICI Bank, Kotak Mahindra Bank, IDBI Bank, Oriental Bank of Commerce, Central Bank of India , Allahabad Bank, Axis Bank and Citibank among others. **Investments** Under the scheme, a person needs to invest a minimum of Rs 6,000 per annum in the Pension Account. There is no maximum ceiling, but the tax benefits will be available only up to Rs 1 lakh under Sec 80C of the Income Tax Act. The funds will be managed by six designated Fund Managers, who would make investments in accordance with the guidelines prescribed by the PFRDA. SBI Pension Fund, UTI Retirement Solutions, ICICI Prudential Pension Funds, Kotak Mahindra Pension Fund, Reliance Capital and IDFC Pension Fund have been selected to act as the fund managers. **Portfolio Management** Pension fund managers will manage three separate schemes, each investing in a different asset class. These asset classes are equity, government securities and credit risk-bearing fixed income instruments. Under the high risk- high return E class - equity investment is permitted to subject to a cap of 50% of individual’s investment. Additionally, the fund managers cannot invest in shares of individual companies, but only in index funds linked to the BSE’s Sensex or the NSE’s Nifty. Under G class – the money is invested in safe but low return yielding Central and State Government bonds. C Class scheme falls in between E and G in risk-return trade off and includes investments in liquid funds, fixed deposits, bank and corporate debt instruments, PSU bonds, infrastructure bonds and municipal bonds. **Investment Mix or Auto Choice** Pension Fund subscribers can choose their investment options and indicate the same to the POPs. For those who would rather leave it to experts to decide what the balance should be, there is ‘auto choice’ option. Under this option, for those aged 18-36, 50% of the amount in their pension account will be invested in equity, 30% in corporate bonds and the remaining 20% in government securities. From age 36 onwards, the proportion of investments in equity and corporate bonds will decrease annually while that in government securities will increase till the mix reaches 10% in equity, 10% in corporate bonds and 80% in government securities at age 55. Money invested in the pension fund during the working life of the investor will come back partly as a lump sum and partly as an annual payment or pension upon retirement. The account is portable, that is it can be operated from anywhere in the country, even if you change the job or change the city. There is also a provision for changing the fund manager. **Issues and Challenges** The launch of the New Pension System has been by and large welcomed as it offers hassle free retirement solution to a large section of the society. The NPS, which was earlier thrown open to the Central Government employees, who entered the service after 1.1.2004, has managed to earn an average yield of 14.5 % during 2008-09, which is significant, especially under the present economic circumstances. The taxation is a challenge in making NPS an attractive pension fund. As of now, the withdrawals from NPS have not been given tax exemption, while similar withdrawals from PPF or Employees Provident Fund are not taxed. Investment analysts feel this asymmetry is unfair and should be removed, as all long-term saving schemes should have the same tax treatment during contribution, accumulation and withdrawal. PFRDA too agrees with this view and hopes that the new government may take a decision on this in the full budget. Another issue that is being debated is the PFRDA decision to put a 50 % ceiling on equity investments. A committee chaired by HDFC chairman Deepak Parekh that advised PFRDA in framing the investment norms had recommended that risk-hungry subscribers should have the freedom to invest all their savings in equities. It had also recommended a 65% equity exposure for auto choice. But the PFRDA reduced the equity exposure limit based on the recommendations of the Board of Trustees of the NPS and the advice of the government. While it is argued that equity investment is the appropriate instrument for wealth maximization in the long term, a conservative ceiling appears justified in a country like ours, where the interests of large number of small investors need to be protected. The idea is to differentiate between pension funds and mutual funds. In pension funds it is the 'safety first, return next,' while it is the other way round in case of mutual funds. The ceiling may be pushed up to 60% in future but not beyond. Even, the United States has a equity exposure ceiling in the range of 50-70 %. New Pension System is arguably, the least cost pension fund in the world. The cost of fund management is 9 paise per 1000 rupees. In February, the six fund managers – ICICI Prudential Pension Funds Management, IDFC Pension Fund, Kotak Mahindra Pension Fund, Reliance Capital Pension Fund, SBI Pension Funds and UTI Retirement Solutions – were selected on the basis of a technical evaluation, which was followed by a bidding process. With UTI emerging as the lowest bidder, the others were asked to match the bid if they wanted to be a fund manager and the remaining five players grabbed the opportunity. Now most Fund Managers are complaining that the 9 paise fee is too less, as investment managers do not come cheap, even during recessionary period. But, at the same time, no one has approached PFRDA demanding higher fees. **The Outlook** The New Pension System has already been notified by 22 state governments for their employees. According to preliminary estimates, the pension business could reach Rs 50,000 crore in five years and rise to Rs 1,50,000 crores by 2015. By then India, would also have joined the list of developed countries, where Pension Funds hold a strategic position in investment markets. *Director, Press Information Bureau, Mumbai