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India's Pension Reform: Compulsions, Challenges and Outlook

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The **microPension-VISA LAB** is an India-based non-profit focussed on retirement literacy and design and pilot-testing innovative market-led solutions to improve access to contributory social security programs by low income informal sector workers in developing countries.



India's Pension Coverage Gap



-  Excluded informal workers who can save for old age
-  Unpaid workers and workforce aged >60
-  Lifetime poor, dis-savers
-  Formal sector workers with pension benefits

Policy Compulsions

- ▶ Civil servants are ~7% of India's workforce but have caused an IPD of 65% of GDP (2006).
- ▶ >300 million informal sector workers excluded from formal pension programs.
- ▶ ~90% of the 100 million current old do not get a pension; India's elderly will double by 2030.
- ▶ Barely 30 million taxpayers.
- ▶ Policy options: Encourage self-provision by excluded young workers; Close the tap on civil service pension liabilities.



Difficulties with Initial Conditions

- ▶ 300 million excluded individuals with fragile labour attachments
- ▶ Life expectancy near OECD country levels.
- ▶ Low literacy; Lower financial and retirement literacy: Concepts of 'retirement' or 'pension' do not resonate.
- ▶ Low intermittent incomes, tiny savings highly sensitive to transaction costs.
- ▶ Modern finance could convert micro-savings into a meaningful annuity. But most excluded households have negligible experience with formal finance or access to banking and regulated payment systems.
- ▶ Frequent migration across jobs and locations.
- ▶ Mandatory coverage will not work; Neither will tax incentives.



Retirement Portfolios of most Indians...

1. Children
2. God
3. *Karma*
4. Government



Resultant Pension Outcomes of most Indians



Strengths of Initial Conditions

- ▶ Small legacy problem – no population-wide DB system
- ▶ We started *early* – in our demographic transition
- ▶ We started *late* – learnings from other countries
- ▶ Experience with building robust nationwide IT systems
- ▶ Strong financial markets, tiny transactions costs
- ▶ 250,000 bank and postal branches, Over 1 million micro-payment outlets
- ▶ Reasonable economic growth
- ▶ Strong political will



Pension System Design Considerations

Objectives	Compulsions	Design Outcome
Sustainability	Budget neutral	DC
Scalability	300 mn workers, 3.3 mn sq kms	Extensive use of IT
Low fees/charges	Small transaction sizes, modest account balances	Unbundled architecture, bidding, Harness existing distribution/ outreach
Simplicity	Low literacy, lower financial literacy	Limited, standard choices
Portability	Changes in jobs, locations and risk profiles	Individual accounts, central recordkeeping
Flexibility	Heterogeneity, enforcement issues	Mostly voluntary

India's National Pension System

- ▶ Fully funded, portable individual pension accounts
- ▶ Specialized pension fund managers selected through a competitive bid
- ▶ Three simple, standard product choices; Life-cycle default
- ▶ Subscribers can switch across products and fund managers
- ▶ Mandatory annuitisation of 40% terminal balance
- ▶ Nationwide access through banks, post offices and finance distributors
- ▶ Subscriber protection by a dedicated statutory regulator (PFRDA)



Progress to Date

- ▶ Statutory regulator set up post Parliament approval.
- ▶ Mandatory participation in NPS by all new civil servants since 2004; ~3.5 million government employees covered already. AUM of ~\$6 bn.
- ▶ NPS extended to all citizens in 2009 on a voluntary basis.
- ▶ Annual CCT of Rs.1000 for low income workers to encourage voluntary participation and top-up benefits. Several State Governments provide an additional CCT of Rs.1200 per year.
- ▶ Roughly 3 million excluded workers have opened NPS accounts in 5 years. But less than 14% of them save enough to avail the subsidy.



Next Stage Priorities

- ▶ Sustained nationwide public awareness campaign to step up voluntary enrollments and build a mass-market for the NPS.
- ▶ Occupationally segmented product packaging and communication.
- ▶ Targeted financial literacy programs with farm cooperatives, microfinance firms, NGOs, self-help groups.
- ▶ Harness secure, portable, affordable and convenient electronic micro-payment solutions (prepaid cards, mobile payments) to ease regular micro-savings.
- ▶ Focus on persistency and optimum savings values.
- ▶ Provide an integrated social security solution with life, disability, accident and health insurance to NPS subscribers.



This is Beginning to Work...



Summary

- ▶ India is at an early stage of its demographic transition.
- ▶ Existing pension provisions in India have important weaknesses.
- ▶ India's NPS is focussed on IT, individual choice and low costs.
- ▶ The NPS will not work for India's lifetime poor, unpaid workers, those nearing retirement or the current old.
- ▶ But it can achieve a coverage that is larger than the populations of most countries.



Effective Implementation Can Work



THANK YOU

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