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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.





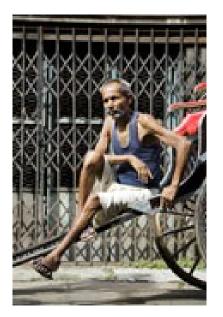
#### **Retirement Portfolios of most Indians...**

- 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 micropayment solutions (prepaid cards, mobile payments) to ease regular microsavings.
- 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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