

Crisil Young Thought Leader: 2009

DISSERTATION ON

**Has the Indian retirement fund industry
come of age?**

By

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Executive Summary

There are eighty million elderly people in India and this segment of is growing at a rate of 3.8% per annum when the rest of Indian population is growing at the rate of 1.8% per annum. Of the entire Indian population only 13% have a pension cover. India has adopted a system of pension where by the employee and employer contributes to the pension amount. These schemes however cover only the organized sector which is a miniscule amount compared to the unorganized sector.

There have been several pension schemes introduced in the past for voluntary participation however none of them have managed to take off well. The problems that were spotted before were the low investment returns because of the pension money invested in safe assets like g secs and that the investors do not get to choose their fund managers. These problems were corrected in the new pension scheme which allows the investor to choose the asset class he would want his funds to be invested in. In spite of this the NPS has had a slow start.

There are several problems facing the pension sector which can be identified

- Under developed distribution network
- Low Level of Financial Literacy of people
- Inadequate efforts being made to sell the pension schemes to people
- A psychology of saving for the short term than long term

These problems can be tackled by the following steps

- Use the distribution network of the Indian Postal System
- Have financial literacy drives on a large scale in rural India
- While marketing pension schemes, do proper market segmentation and position the schemes after having understood the savings behavior of people
- Use MFIs, LIC and NGOs for the marketing and distribution of pension products

Besides this it is necessary to look at the following aspects

- The possibility of active fund management as alternative given to the investor and charging him higher for the same. This would attract the younger population
- The life expectancy of people is rising in India and with this are the expected costs for healthcare. This aspect should be taken care of while designing the social security system

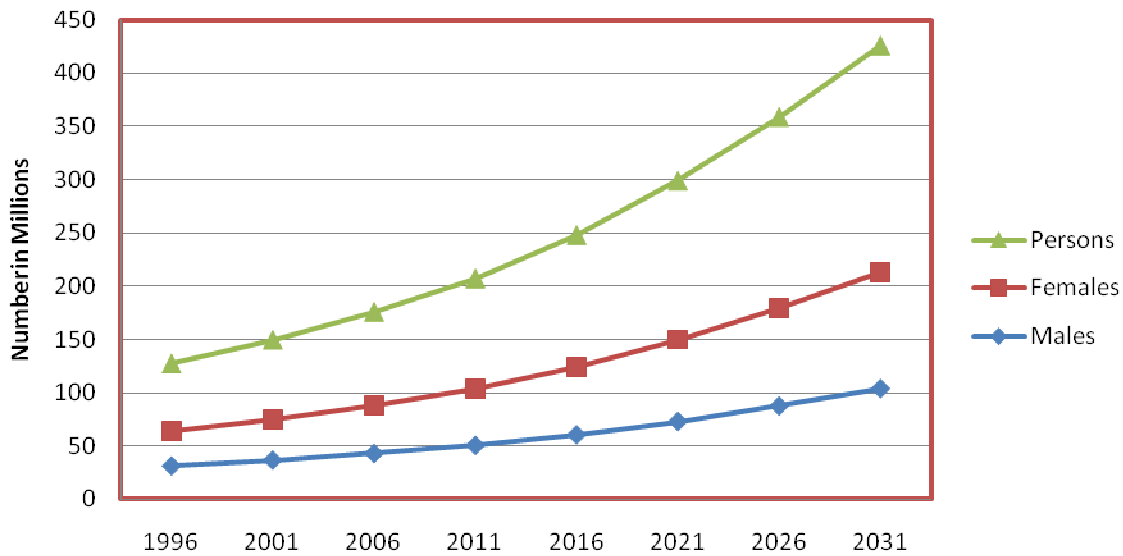
A well developed pension system is important for adding liquidity to the capital markets and can play a huge role in economic growth of the nation. The pension sector is important for the alleviation of poverty in old age and sufficient efforts should be taken to understand the pensioner to market pension schemes to him.

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India's Demographic Profile

Census of India Projections for persons above 60



Analysis of the Demographic Profile

- The proportion of the elderly (those above 60 years of age) in the total population is expected to increase to 13 per cent by 2025 that is to 350 million. Besides the increasing number of the elderly, India is also witnessing longer life expectancy at age 60. The present average life expectancy at the age 60 is expected to increase in the coming years.

	Employment (Million)		
	Formal	Informal	Total
Organised	30.66	25.79	56.45
Unorganised	4.02	336.29	340.31
Total	34.68	362.08	396.76

- 85% of India's population is working in the unorganized sector. These people can be working in sectors ranging from agriculture to small scale industries and have varying needs of retirement benefits. They have varying saving habits and are a heterogeneous group. It is necessary to understand each one of them before designing of any kind of social security scheme for these people.
- As seen from the figures below, the literacy rates are substantially low in the rural areas. Unless and until this problem is addressed the issue of financial planning cannot

be conveyed to the rural illiterate population. This shows the importance of sound planning for improving our education system.

	Males	Females	Persons
Total	75.3%	53.7%	64.8%
Rural	70.7%	46.1%	58.7%
Urban	86.3%	72.9%	79.9%

- Only 4 to 5 percent of the aged live alone. Less than 1 percent are inmates of old-age homes. About 30 to 31 percent of the aged males in rural and urban areas are fully dependent on others. The corresponding figures for females in rural and urban areas were 71 and 76 percent, respectively.
- The above statistics tell us the dependency levels of the aged on others for their income. The traditional sources of finance like relatives are increasingly diminishing. This shows us the importance of a well developed pension system in India.

Current Social Security System in India

Mandatory Schemes	Voluntary Schemes	Social Assistance
* Employees' Provident Fund	* Public Provident Fund	* National Old Age Pension Scheme
* Employees' Pension Scheme	* Group Pension Plans	* Annapurna Scheme
* Central Civil Service Pension Schemes	* Unorganized Sector Worker's Social Security Scheme	* State Government Social Assistance Schemes
* General Provident Fund	* Personal Plans: Mutual Fund Pension Plans	
* Coal Miners' Prov. Fund	* Life Office unit-linked plans	
* Public Sector Bank employees' schemes	* Life office Annuity schemes	
* Seamans' Provident Fund	* Senior Citizens Savings Scheme "Dada Dadi"	
* Assam Tea Plantations PF		
* Exempt Employers' Trust Funds		
* Gratuities Scheme		
* Employees Deposit Linked Insurance Scheme		

Social Assistance Schemes for the poor: Social Assistance Schemes provide assistance to the life time poor. These schemes are targeted at the destitute and poor and the infirm population over the age of 60 years. These schemes are usually under funded, poorly targeted, and suffer from significant leakages. At present, majority of the workers in the unorganized sector are protected only through the efforts of welfare bodies, the community, or NGOs

Occupational Pension Schemes: These refer to employer sponsored schemes that are not statutory, but provide additional post-retirement income to employees on a regular basis. These are governed under the Income Tax Act by the tax authorities. The liabilities are met by setting up Trust Funds, either self-managed or managed by the Life Insurance Corporation of India (LIC). However these schemes cover only the organized sector workers who form

Voluntary Pension Schemes: These comprise Post Office Savings Bank Schemes, Public Provident Fund (PPF); individual and group annuities of life insurance companies.

Except for the annuities, the other savings schemes have enjoyed administered rate of returns, and some such as the PPF are essentially tax-shelter devices for the high income groups

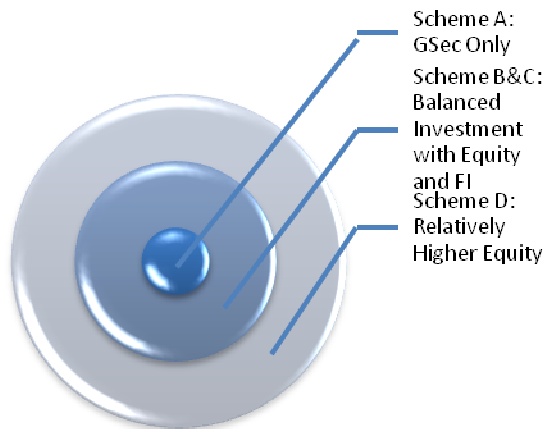
Apart from the Employees Pension Scheme (EPS), which provides a defined annuity stream for a portion of the retirement benefit, existing schemes are mostly lump sum and do not pay income streams from the time of retirement. Consequently, it becomes necessary for retirees to make their own arrangements including the purchase of annuities from life insurance companies.

New Pension Scheme

The New pension scheme is a defined contribution scheme that was introduced for the government workers in 2004 and has been made open on voluntary basis to other Indian Citizens since 2009.

Salient Features

- Bank branches and post offices have been appointed as service providers who will collect contributions
- 6 pension fund managers appointed and the investors can choose their preferred fund manager
- Central record keeping agency has been appointed
- Scheme is portable across jobs and locations
- Each individual can have a voluntary tier-II withdrawable account at his option. Government will make no contribution into this account. These assets would be managed in the same manner as the pension. The accumulations in this account can be withdrawn anytime without assigning any reason.
- The fund managers would invest the savings of people investing them in three asset classes, equity (E), government securities (G) and debt instruments that entail credit risk (C), including corporate bonds and fixed deposits
- Subscribers can change the allocation of investments among the different asset classes, although exposure to equity has been capped at 50%. For a saver not yet 35 years of age, half the investments will go into asset class E, one-fifth into asset class G, and the rest into asset class C. Above the age of 35, the default proportion going to equities would come down and the proportion going to government securities, go up. By the age of 60, these investments will gradually be adjusted so that only one-tenth remains in equities, another one-tenth in corporate bonds and 80% in central and state government bonds
- Fund management charges are very low (0.0009% a year), as compared with mutual funds. The cost of opening and maintaining a permanent retirement account, and the transaction charge on changing address, pension fund manager, etc are around Rs 400



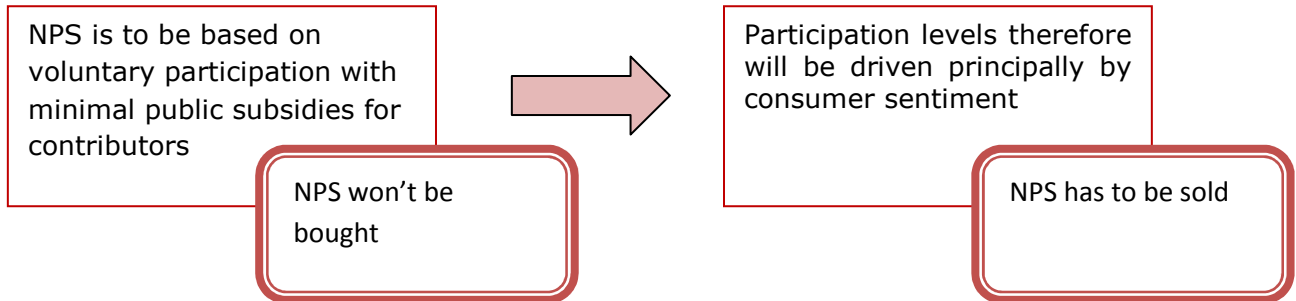
Performance of NPS

- **2352 forms were collected as on October 23rd 2009 across 798 branches**

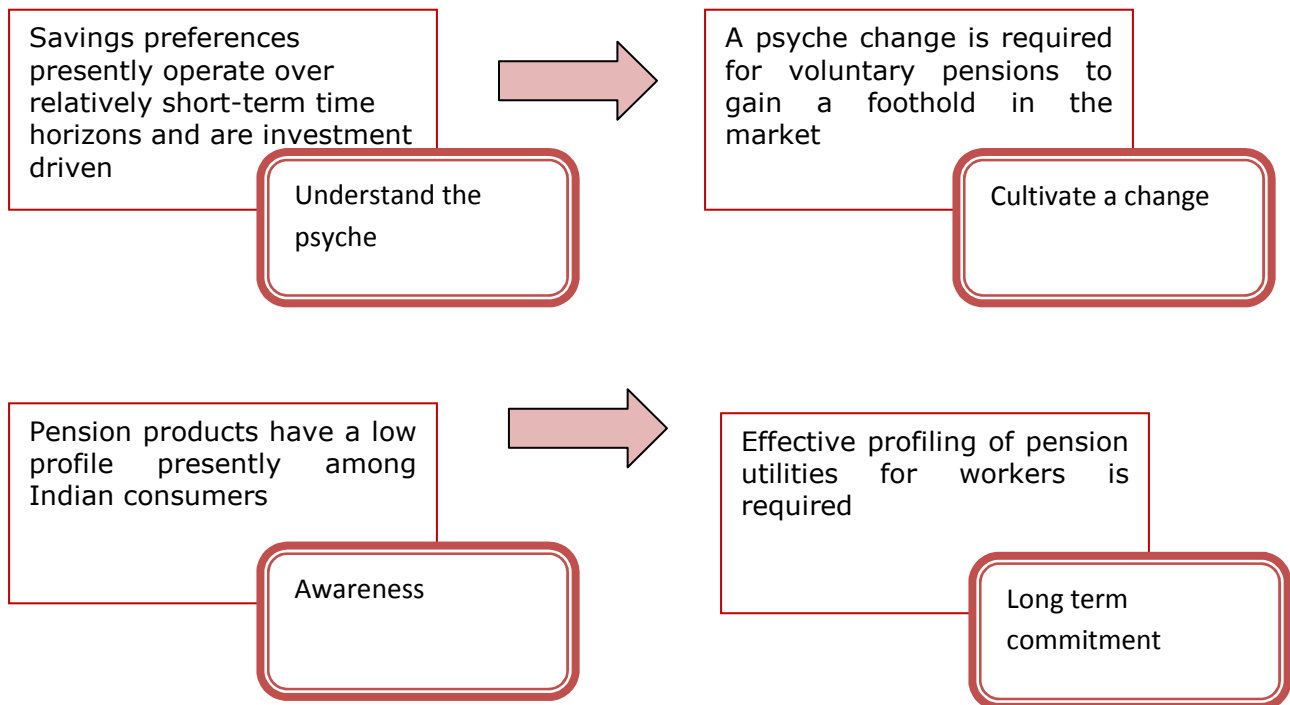
The Problems Encountered

- Lack of awareness
- Lack of tax benefits
 - At the time of retirement one can withdraw 33 per cent of the contribution and the rest 67 per cent is used for annuity, which is taxed. There should not be any tax at the time of withdrawal
- Lack of adequate provisions to push NPS
 - There are no agents for the scheme. This has been done with the aim of keeping costs down.
- No commission to PoPs
 - The collectors are main points of contact between the investors and the fund
 - The financial institutions that serve as PoPs earn Rs.40 when an NPS account is opened. They get Rs.20 for subsequent transactions. Thus there is no incentive they have for selling the scheme.
 - Monetary incentives need to be given to distributing agency
 - Offer a volume based incentive

Identifying Constraints



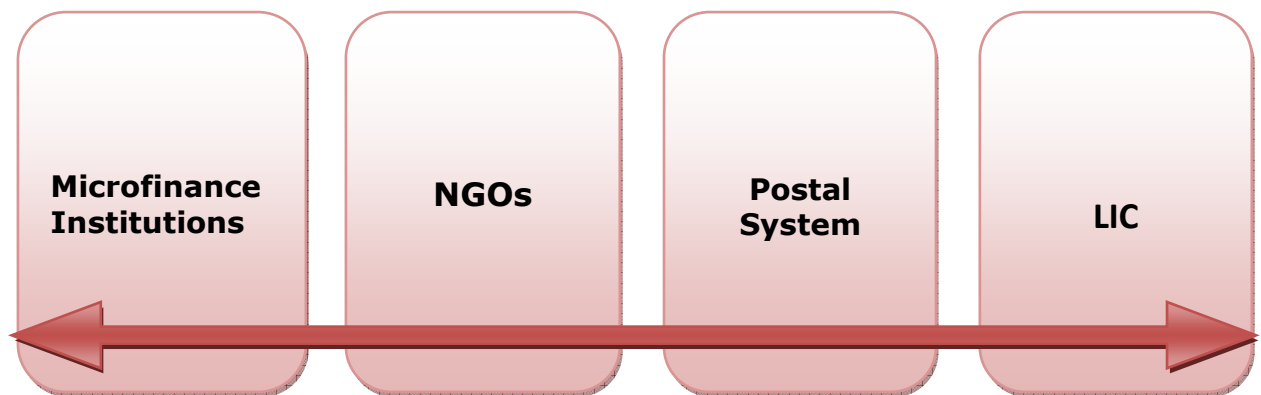
The authorities need to understand that long-term financial products are not bought but are sold. These products work by the push factor and not the pull factor. NPS is depending on its attractiveness as a product considering a low service charge. However its selling that works for these products and not marketing.



Recommendation

- The opportunity for cross selling pensions through the Indian life insurance sector as one potentially effective NPS sales platform should be considered
- NPS marketing should be based on the principle of encouraging deferred consumption as the central concept of pension savings
- Market segmentation should be done to identify the target segments and marketing strategies to each segment must be carefully designed
- On the taxation front NPS must be brought to the same levels as the other pension schemes
- A research must be carried on into the savings behavior of people

Channels for marketing



Microfinance Institutions

MFIs have great reach in the sub economic groups. They have access to community groups that might have received loan support from MFIs for local projects. If their support can be gained it would be beneficial, however, like banks they are unlikely to provide services without charging.

NGOs

NGOs have a good spread of contacts. These NGOs are apt for the promotion of NPS and should be approached via a marketing program that emphasizes the social good that would emerge in the long term through participation in NPS

LIC

LIC has more than 10 lakh agents who can act as intermediaries at some level of the distribution chain

Indian Postal System

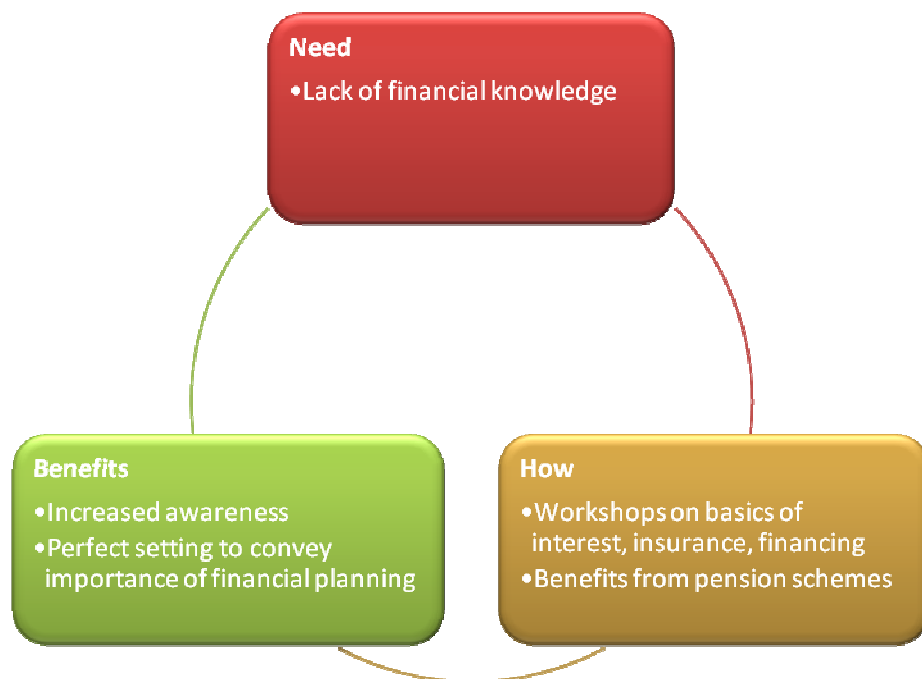
The greatest potential exposure of NPS to all of India is likely to come through the Indian postal service,

although the data indicates that only a small proportion of the most likely initial entrants to NPS utilize India Post exclusively. Its net is wide and extends to villages and communities beyond the reach of banks.

- India Post consists of 155,000 branches servicing 600,000 villages
- Already involved in acting as POP for mutual fund products, cash management trusts, as well as the traditional financial investments such as National Savings Certificates and PO Savings Accounts
- Talks are happening to make them POPs for NPS
- The postal system operates on the principle that the net funds at any branch post-office or sub post-office are cleared on a daily basis; only head post-offices maintain funds. This integrates efficiently into the pension system: the head post-offices can interact with the banking system to transfer funds to the pension system. The department of posts has also experienced significant success with a large-scale implementation of IT and telecommunications systems

Financial Literacy: Tackling the Core Problem

It has been observed in India that the capability of those who need to make financial decisions is too often inadequate in terms of basic literacy and numeracy, as well as in respect of specific financial knowledge. A majority of our households do not use modern financial markets. As per an RBI report, only 1.4% of household savings was invested in equity, mutual funds and debentures in 2003-04. Though this went up to about 4% in 2005-06, it is still very small. In order to understand products like pension funds it is necessary to have a clear understanding of concepts like interest rates, inflation, amortization and percentages. Without this any effort to sell the pension schemes is futile. Hence efforts should be taken improve the financial literacy of people. Also it is important to convey the importance of financial planning in this drive. These programmes should be multilingual.



Conclusion

The objectives of ability to consumption and poverty alleviation are of paramount importance. By providing a safe vehicle for long term savings, a well-designed pension system can improve the lives of millions of Indian citizens in the decades to come. A strong pension system can it can effectively channel resources from savers to the private sector firms that can promote economic growth. A well designed pension system will also increase the flow of funds into the government securities market. The increasing efficiency of capital markets and government finances can generate indirect benefits for the rest of India's vast population.

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- Demographics Of Aging In India: Institute of Economic Research, Delhi



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EDUCATIONAL QUALIFICATION

YEAR	DEGREE	INSTITUTE	BOARD/ UNIV.	RESULTS (%)
2009	MMS – I	Jamnalal Bajaj Institute of Management Studies	Mumbai	73.6
2008	B.E. (Etrx.)	Dwarkadas J. Sanghvi College of Engineering	Mumbai	75.1
2004	H.S.C.	Sathaye College	Maharashtra	90.1
2002	S.S.C	Parle Tilak Vidyalyaya English Medium	Maharashtra	89.3

ACADEMIC SCHOLARSHIPS & AWARDS

- Secured 4th rank in Electronics branch in the final year of engineering (2007-08)
- Awarded **J.R.D. Tata Scholarship** for academic excellence in second year of engineering (2005-06)
- Secured 4th rank in Electronics branch in the second year of engineering (2005-06)
- Awarded **Silver medal** in Dr.Homi Bhabha Science Talent Search Competition conducted by The Greater Bombay Science Teacher's association (1998)
- Awarded Maharashtra State Scholarship in 7th Standard for securing **State Rank 20** (1999)

SUMMER INTERNSHIP

Organization: Citibank N.A.

Period: May '09 – Jun '09 (2 months)

Division: Securities and Fund Services

Location: Mumbai, India

Project Title: Study trends in trading, clearing and settlement in EU and models for clearing of OTC derivatives like Interest Rate Swaps

Project Description:

- Study trends in trading, clearing and settlement in EU after the introduction of MiFiD and the European Code of Conduct and understand new trading venues like Multilateral Trading Facilities and models like dark pools of liquidity
- Interact with the Citibank London SFS team to understand the implications of changes in the securities industry on their business model
- Conduct a market sizing exercise for Interest Rate Swaps in India and forecast the revenues expected to help CITI analyse the feasibility of providing central counterparty services for IRS in India

Awarded a Pre-Placement Interview (PPI) from Citibank for outstanding performance

CORPORATE PROJECTS UNDERTAKEN

Interest Rate Futures

Organization: Finstream Financial Advisors Ltd.

- Analyzed the issues that led to the failure of Interest Rate Futures in India
- Studied the concepts of Interest Rate Futures like Cheapest to deliver bonds and Conversion Factor
- Submitted a report on treasury bond futures that have been introduced in India

POSITIONS HELD & PARTICIPATION

Positions Held:

- Elected Member of the **The Catalyst Forum** at Jamnalal Bajaj Institute of Management Studies (2008-10)
- Member of **Magazine Committee** of DJ Sanghvi College of Engineering (2007-08)

Participation:

- **Campus Champions** at **The War Room** conducted by **The Mahindra Group** (2009)
- Finalist at **The Paper Presentation Competition** conducted on an All India level by **IFCI** (2009)
- **1st runners up** at **'Finvest' the Equity Research Competition** of **JBIMS** (2009)
- **2nd prize** at **'Freatoutnomics', an economics based simulation game** at **NMIMS** (2009)