National Pension System (NPS) and the Corporate Sector*

I thank Mr. Sriram Iyer, MD & CEO, HDFC Pension Fund (HDFCPF) for the opportunity to interact with this distinguished gathering. I congratulate HDFCPF for crossing this milestone of Rs. 50,000 crore of pension assets under its management. These pension assets have largely emanated from the private sector: corporate employees and individuals. In terms of assets under management, HDFCPF stands fourth among the ten currently incorporated pension funds. If we were to look at only the private sector clientele, HDFCPF jumps to the second spot, a creditable achievement indeed.

What is pension?

It is a financial product with certain characteristics to meet certain financial goals. It could be seen as a long-term savings product ensuring steady flow of income through one's post-retirement life. Since, it is a product designed for pay off in the future, it has some inbuilt lock-in characteristics. The essence of pension is that it has to be accumulated over a long period to harness the power of compounding of returns so that a sizable corpus is accumulated to yield significant pension income in future. As various expenditures and savings products compete for one's income, pension does not become a natural choice; unless it is mandated by one's employer or statutorily required as a part of employment contract. However, pension is required for regular income flow and above all, for dignity in one's post working life. One could retire with a pot of savings but stock of money runs off fast. However, pension does not desert the person till the end of her life.

Pension is necessary

There is a socioeconomic context to why pension is necessary?

First, in our society the deemed insurance of joint family system seems to waning and families are getting atomized. This is more likely an irreversible trend. Hence increasingly individuals have to make provision for their old age income security.

Second, the structure of our labour market. In the estimated labour force of around fifty-six (56) crore, over six (6) crore are in the organized sector who have statutory access to some form of post-retirement social security benefit. Hence, the bulk of the labour force would have to make provision, during their working life, for post-retirement income.

Third, our demography. We are the most populous country on the face of our planet with an estimated population of over 140 crore. More importantly, our population is young, implying that dependency ratio is currently low. Thus, we are at a demographic inflection point where our young population is expected to drive economic growth and progress as evidenced from the development experience of other countries. As we see from ageing societies in Europe and in East Asia, demographic dividend does not last forever. For example, among other factors, population ageing is contributing to the slowdown in economic growth in China. Our demographic dividend is estimated to peak by 2040, our young population will eventually grey. Hence, income provision for that phase of our development ought to be made now.

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*Remarks by Dr. Deepak Mohanty, Chairman PFRDA at HDFC Pension Fund event in New Delhi on 18th August 2023.

Fourth, we are currently a lower middle-income country with a per capita income of around US $ 2600. If the current trend in per capita income growth is sustained, for sure we will transition to an upper middle-income country sometime in the next decade; and aspire to be a high-income country in the following decade. One implication of this is that the financial ability of our population to afford pension would continue to increase with rise in income. Currently, dedicated pension related assets[1] are estimated to be 16.5% of GDP, in which assets under NPS including Atal Pension Yojana (APY) accounts for 3.6% of GDP. The average pension assets in the Organisation for Economic Co-operation and Development (OECD) countries are over 70% of their GDPs with some countries having pension assets over 100% of their GDP.

Finally, in the current distribution of financial assets, the allocation towards pension is relatively less. Hence, there is a potential for pension assets to grow but it needs greater awareness and sustained effort from the stakeholders, including the pension funds.

National Pension System

National Pension System (NPS) was introduced as a defined-contribution (DC) pension plan with co-contribution by the government and the employees who joined central government (except for armed forces) with effect from 1st January 2004. Subsequently, a number of state governments adopted NPS. It was extended to all citizens in May 2009, following which, to corporates in 2010. Since then, NPS has made significant progress.

Between March 2019 and August 2023, the number of subscribers has increased from 80 lakh to 136 lakh, and assets under management have increased over threefold from Rs. 3.1 trillion to Rs.9.7 trillion[2]. The NPS corpus is invested in equity and debt. It has generated competitive returns. For example, since inception, the equity scheme has given an annual average return of about 12.5% and the government debt scheme has given a return of over 8.6%.

The NPS is a flexible scheme giving the investor the choice of fund managers and asset allocation. It is portable across employers and across employment (salaried or self-employed). NPS can be continued even with change in residency status, as it is open to NRIs (non-resident Indians) and OCIs (overseas citizens of India).

Over 13,500 corporates have joined NPS. However, the take up rate with employees, though increasing, is slow. The number of corporate employees in NPS, between March 2019 and August 2023, have increased threefold from 8 lakh to 18 lakh. Hence, there is a scope for larger number of corporate employees joining NPS with greater awareness and facilitation, where pension funds have an important role to play.

Conclusion

Let me conclude. First, longevity risk. As people live longer, it becomes incumbent to accumulate larger retirement corpus so that it lasts longer post one's working life. In addition, increasing health care expenses need to be provisioned. It is seen from the experience of the advanced countries that despite access to multiple pension benefits, post-retirement income is

[1] includes corpus under EPFO, PPF, Life Insurers (Pension & General Annuity & Group Fund), NPS, Mutual Funds (Pensions), Approved Superannuation Funds (self-managed) and Statutory Provident Funds (Coal Miners, Seamen, J&K, Assam Tea Plantation).

[2] Excludes NPS Lite and APY.

found to be less than adequate given the expenditure. Hence, there is a need for everyone to have a pension account. The belief that a single post-retirement account for the head of the family is sufficient for the family is somewhat misplaced. Considering their higher longevity, women in the family must have a pension account.

Second, tax treatment. For corporate employers, contribution to employee retirement benefit, including NPS, is tax neutral. In order to nudge employees, corporates may consider offering NPS as an additional benefit with some initial contribution. In a Corporate NPS, employer contribution upto 10% of salary is treated as perquisite and simultaneously allowed as deduction from total taxable income. In addition, under the old tax regime, NPS contributions by individuals are allowed as deductions from income upto a limit of Rs.1.50 lakh with an additional deduction upto Rs.50,000 over and above the Rs.1.50 lakh limit.

Third, pension literacy. It is seen globally that financial literacy remains low even among educated masses. There is, therefore a need for intermediaries such as pension funds and points of presence (PoPs) to work towards increasing pension awareness both through digital outreach and in physical form. We have permitted PoPs to utilize the services of agents for NPS which should facilitate physical outreach.

Fourth, the intermediaries should look to expand the base of subscribers. Survey data suggest that those who can financially afford to have NPS are still not adequately covered. For example, inclusion of women is less. Similarly, spread of NPS among professionals, small business and self-employed is relatively less. I may mention that professionals and self-employed could avail of tax exemption upto twenty per cent (20%) of their gross income subject to a limit of Rs. 1.5 lakh by contributing towards NPS and further avail the additional tax benefit of Rs.50,000.

Finally, NPS is going to expand as income levels rise and awareness improves. However, pension is not a natural pick by youngsters. There is a need for enablement. As a regulator, we have made NPS fully digitally accessible, the scheme flexible, low cost with a lower threshold of entry. It is necessary for intermediaries to reach out to the potential customer base.

Thank you.