

Regulation and Supervision of Pension Funds in India

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Agenda

- Reforming India's Pension System
- Current Pension Regulatory Frame-work
- The PFRDA Bill 2005
- Pension Regulatory Body for India - Objective and Role
- New Pension System Regulations
- Occupational Pensions Regulations
- Public Education on Pensions
- Summing up

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Reforming India's Pension System

- The Government of India had constituted an Expert Committee under project OASIS for devising pension system for India.
- This Committee, known as OASIS Committee, recommended introduction of DC Fully Funded Individual Retirement Account Pension with universal access.
- The two significant achievements of the OASIS Committee have been that its two reports:
 - initiated debate on the need to reform India's pension system; and
 - created awareness about the need to provide for old age income.

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Reforming India's Pension System

- Following these reports and the public debate thereon, the Government of India initiated pension reform process.

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Reforming India's Pension System - Government of India Initiative

- The major Government of India initiatives for reforms have been:
 - Moving the Central Government employees joining service on or after 1st January 2004 to DC pension system;
 - Many state governments responding to Central Government's plea to introduce the DC scheme for their new employees;;
 - Setting up of the Pension Fund Regulatory & Development Authority (PFRDA) by an executive order; and
 - Introduction of the PFRDA Bill 2005 in the Parliament.

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Reforming India's Pension System - Need For Regulatory Frame-work

- The reforms initiatives need to be supported by a clear regulatory and supervisory frame-work.
- The significant aspect that stands out in pension reforms initiatives in other countries is the need for a clear regulatory frame-work and a strong regulatory authority.
- The Government of India initiatives are aimed at achieving this objective.

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Current Pension Regulatory Frame-work

- The current pension regulatory framework :
 - the State pensions are generally not under the purview of any regulatory authority;
 - PPF administered by the government is not under the purview of any regulatory authority;
 - EPF and EPS 95 are administered and regulated and supervised by the EPFO;
 - occupational pensions and gratuity funds - investment pattern supervised by the CITs and other aspects left to self-regulation by actuaries and auditors; and
 - personal and group pension products regulated and supervised by the IRDA.
- The regulation and supervision of pensions is thus fragmented and needs total review.

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The PFRDA Bill 2005

- The PFRDA Bill 2005 was introduced in the Parliament in March 2005 and was referred to the Standing Committee on Finance.
- The PFRDA Bill, when converted into an Act, is envisaged to apply to:
 - the New Pension System (NPS); and
 - any other pension scheme not covered by any other enactment.
- It excludes from its purview:
 - all provident funds and EPS 95;
 - contracts referred to in sub-section 2(11) of the Ins Act 38
 - any other pension scheme which the Central Government may exempt from the application of the Act.

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The PFRDA Bill 2005

- In simple terms:
 - the PFRDA would regulate and supervise the NPS and all pension funds other than those specifically exempted; and
 - the IRDA would regulate and supervise pension products offered by life insurers.
- The PFRDA Bill is modeled on the lines of the SEBI Act and the IRDA Act and does not cover all policy aspects as are covered by the Insurance Act.

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The PFRDA Bill 2005

- The Standing Committee has recommended that important issues like:
 - minimum capital requirement;
 - foreign equity in pension sector;
 - issue of guarantees to the subscribers;
 - withdrawals from pension accumulations;
 - decision on public sector fund manager;
 - selection criteria for PFM
- be spelt out in the Act.
- It would be desirable that the PFM structure is also covered in the PFRDA Act.

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The PFRDA Bill 2005

- The PFRDA like the IRDA, is entrusted with developmental role.
- Considerable developmental work will be required to make the community at large understand the need and importance of self financing of old age income.

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Pension Regulatory Body for India - Objectives

- The principal objective of any regulatory body is to protect the consumers and ensure that they get fair deal.
- This protection and fair deal do not remain confined to financial viability but encompasses many other aspects aimed at benefiting the consumers.
- The regulations should set out the basic rights and obligations of the relevant parties - the pension scheme members, the trustees, the employer, the service provider.
- The integrated package of legislation along with self regulation through the actuaries, auditors and other professionals should help in achieving a fairer and more secure framework for pension system.

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Pension Regulatory Bodies for India - Role

- The regulatory body should ensure that security of pensions is not put to risk and that management systems are sound.
- Regulation and supervision should not be through imposition of minutely detailed legislation.
- A broad framework be so laid down that the objective is achieved through self regulation and minimum regulation through legislative processes.
- The PFRDA would regulate and supervise the New Pension System (NPS) and 'other pensions' not covered by any other enactment.

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Pension Regulatory Bodies for India - Role

- The regulation and supervision of occupational pensions is somewhat different from that of the providers of other financial services .
- This is because, occupational pension schemes are large in number and there exists great diversity in the way these are set up and managed.
- Providers of other financial services are relatively few in number and more homogeneous in nature
- This has led to the pension regulatory authorities being less proactive and more reactive and this had led to much of criticism of the OPRA in the UK.

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Pension Regulatory Bodies for India - Role

- The current approach is, however, to operate proactively to anticipate problems, concentrating on schemes having high risk and bad governance.

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New Pension System (NPS) - Vehicle Structure

- The decision about the precise structure of the vehicles that would offer the NPS is yet to be announced.
- The possible structure of the vehicle could be:
 - a separate entity;
 - a facility for this pension within the existing business setup with a Chinese wall separating the two businesses; or
 - pension business allowed to be transacted within the existing business setup without Chinese wall .
- Information available in the public domain gives an impression that the vehicle may be a separate entity.

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New Pension System Regulations - General Framework

- Once the PFRDA Bill is converted into an Act of Parliament, the PFRDA would have to frame regulations for the NPS, covering:
 - eligibility criteria for entities seeking registration as PFM, CRA, PoP;
 - the process of selection of PFMs, CRA/s and PoPs;
 - fund management norms;
 - 'minimum standards' in respect of various parameters;
 - charging structure;
 - should there be a charge for transfer in/out of the scheme;
 - clearing house operations;
 - annuitisation;
 - marketing and distribution;

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New Pension System Regulations - General Framework

- For NPS regulations, it may be useful to draw on the philosophy and important features of the Stakeholder Pension in the UK, a scheme similar to the NPS.
- The significant distinguishing feature of the Stakeholder Pensions in the UK is the 'minimum standards'
- The pension of this type, would distinguish itself from other pensions on offer because of 'minimum standards'.
- The wide variation between the terms and conditions offered by different schemes does not facilitate easy comparison.
- Introduction of 'minimum standards' for stakeholder pensions ensured a level of standardization across schemes which facilitated easy comparison of what was on offer.

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New Pension System Regulations - General

Framework

- "Minimum standards" have been set for the fees that could be charged, minimum contributions allowed, freedom to stop and start contributions, freedom to change providers, investment choice and information.
- A single annual management charge, with all charges rolled into it, related to individuals' funds under management was allowed.
- The prescribed limit on charges was seen as a valuable safeguard for subscribers and was envisaged to provide an important degree of confidence in scheme.
- The regulations have to specify what the charge limit covers and by extension, what services may be charged for separately.

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New Pension System Regulations - General

Framework

- A single charge structure could be onerous for NPS.
- Maybe, a two charge structure, one related to contribution and the other related to AUM could be more viable.
- To meet the requirement of death and disability benefits, Chilean model could be followed.
- In Chilean model, PFM are not allowed to make any deduction for costs or profits from 10 % contribution paid by the subscribers. Additional 2 - 3% contribution is paid to cover costs, profits and other benefits.

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New Pension System Regulations - General Framework

- Products, i.e. types of funds, to be offered may have to be specified with asset allocation left to the PFMs.
- Detailed norms for investments, similar to the SEBI MF Regulations may have to be drawn up.

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New Pension System Regulations - Mandatory Coverage for Workers in Small Establishments

- As per OASIS report, 28 % of the salaried workforce (13mn) did not have access to any formal designated vehicle for building up retirement benefits.
- To cover this workforce, it may be made mandatory for establishments having five or more employees to provide to their workers access to the NPS.
- Access would mean deduction of contribution and remitting those to the chosen PFM under NPS.
- Stakeholder Pension regulations have such provision.

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New Pension System Regulations - Information to the Subscribers

- It is essential to ensure that subscribers receive clear and good quality information on their pension accumulations.
- In the UK, after four years of public debate, all DC pension providers are required to give annual statement showing the projected value of the individual's fund at retirement age and the amount of pension it might buy at current prices.
- The statement makes it clear that the values are only estimates which depend on unknown variables that will inevitably change over time.
- Since the statement is given every year, subscriber expectations are managed practically on ongoing basis.

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New Pension System Regulations - Information to the Members

- This requirement helps the subscribers to have idea about the likely final "pay out" on ongoing basis and facilitates subscriber action for achieving targeted pension.

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Occupational Pensions Regulations

- The structure of occupational pension is well established.
- The occupational pensions administration could be of the type where the Trustees :
 - administer the fund and buy annuities from life insurer;
 - administer the fund and also pay out pension; or
 - go in for life insurance company pension scheme.
- The occupational pension regulations would have to cover all the above types.
- Gratuity is a mandated final salary based defined retirement benefit.

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Occupational Pensions Regulations

- The regulations would have to cover :
 - pension promise;
 - funding;
 - interests in pension fund and surpluses;
 - pension fund trustees;
 - amendment and winding up;
 - early leaving;
 - scheme administration;
 - safeguarding the assets of pension fund;
 - protection against the insolvency of employer;
 - information for the scheme members;
 - dispute resolution;

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Occupational Pensions Regulations

- Scheme Actuary; and
- other matters of details.
- In many jurisdictions, DB pension schemes are required to appoint a Scheme Actuary.
- These regulations could have provision to cover Gratuity Funds also.
- The tasks envisaged for the Scheme Actuary are:
 - valuation at specified periodicity;
 - monitoring of the scheme's compliance with the minimum funding requirement;

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Occupational Pensions Regulations

- advising the trustees on a schedule of contributions and recommending transfer values;
- quantifying the benefit cost for company account purposes; and
- certification for tax purposes.

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Legislation Influencing Pension Arrangements

- The trust arrangements and the member's relationship and rights therein are governed by a number of different laws.
- These include the trust law, the contract law, tax law, social security law, employment law, financial services law, insurance law and other general laws.

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Public Education on Pension

- In India, pensions did not develop because of social structure, social psyche, nature of economy and inadequate disposable income.
- Awareness about the need to self finance old age income is being increasingly realized gradually.
- In order to strengthen this process, a massive awareness and education program needs to be undertaken.
- The awareness and education program must start from school level.

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Public Education on Pension

- In India, increased awareness only would drive pension coverage and not tax incentives .
- Provision in the PFRDA Bill for establishment of a fund to be called the Subscriber Education and Protection Fund is a step in the right direction.

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Summing up

- All regulations aim at protecting the consumers and this protection assumes greater importance when dealing with the long term financial contracts like pension.
- It is essential that all pension arrangements are regulated and supervised in a cohesive manner.
- Providing access to the employees to the NPS may be made mandatory for establishments having five or more employees.
- The regulations for the NPS, a pension with universal access, need to be framed on the philosophy of 'minimum standards' to provide fair deal to the subscribers.

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Summing up

- Occupational pension funds need to be regulated and supervised
- A statutory role in the form of Scheme Actuary needs to be created for DB pensions.
- Adequate information need to be provided annually to the DC pension subscribers about the likely accumulation and pension pay out on their retirement.
- These measures would ensure that all pension issues are addressed in a holistic manner and cohesiveness is brought in regulation and supervision of pension business.

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Thank you



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