Civil service and military pensions in India

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Workshop on Civil Service and Military Pension Arrangements in the Asia-Pacific

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Traditional civil services pension (TCSP)

- Unfunded pay-as-you-go defined benefit pension.
- Benefit roughly half of the wages in the last ten months of employment.
- Computed at around 1/60 for each year of service subject to a benefit rate cap at 50 per cent.
- Commutation provision allows employees to forgo 40% of the pension amount and take it as a lump sum at the time of retirement.
- Survivor benefit drops to 30%.
- Similar DB programs for state government employees.

Government employment

- Size of the government expanded in the 1970s and 1980s.
- Early 1990s onwards, growth of government dropped to near-zero levels.
- In 2009-10, 4% of the total workforce in the country employed in the public sector.
- No data on exact number of employees.

Expenditure on government pensions

	Mln. USD			Per cent to GDP		
Year	Centre	States	Total	Centre	States	Total
1990-91	738	706	1,445	0.75	0.71	1.46
2004-05	6,146	8,660	14,826	0.96	1.35	2.31
Growth rate	16.37	19.6	18.1			

Source: Shah (2006)

Estimated implicit pension debt (centre + states + local): 56% of GDP.

Tradeoffs in reform

- High fiscal stress
- Political economy of fiscal soundness
- Political economy of fudge factors of pension formulas
- High macroeconomic uncertainty
- High uncertainty about demographic change and longevity risk
- High GDP growth.

The reform of December 2002

1. Switch new recruits from 1/1/2004 onwards into an individual account DC system
2. A 10% wage hike, and a 20% contribution rate
3. What persuaded the Prime Minister: Under reasonable assumptions the replacement rate would exceed 20%
4. For a few decades, pay benefits on the old and pay contributions to the young.
5. Phase-in for the new recruits eliminated problems of negotiation with civil service unions; there was essentially no opposition.
6. Each state government makes it's own choice: Other than 3 states ruled by communist parties, all others mimicked the central reform.

The administrative challenge

- A political decision to reform does not get the job done
- Need a fully articulated implementation strategy
- India: Low implementation capability in government.
- In particular: Small value contributions and transactions.

Part I

The NPS: Design

Reform Goals

Design a pension system that

- Increases coverage;
- Is sustainable in the long run;
- Is scalable enough to matter on the large area, population and diversity of India;
- Is low cost;
- Is able to reach out to a large mass of unsophisticated participants;
- Provides choice of investment;
- Is backed by sound regulation.

Design options

- *The pension fund* is responsible for the whole range of activities from selling the individual account, to record-keeping to fund-management.
- Example: several Latin American countries.
- Record-keeping works like a public good and is provided by a *single entity, distinct from the pension fund* which actually does the fund management.
- Example: Sweden, Poland, USA (Thrift Savings Plan).

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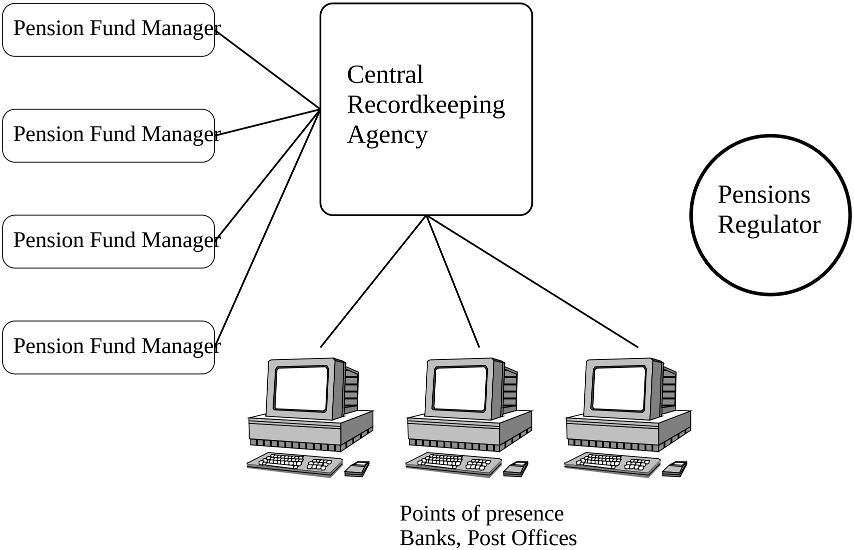

Pension Fund Manager
Pension Fund Manager
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Pension Fund Manager
Central Recordkeeping Agency
Pensions Regulator
Points of presence
Banks, Post Offices

NPS architecture

- Points of Presence (POPs)
- Central Record-keeping Agency (CRA)
- Pension Fund Managers (PFMs)
- Regulator

System requirements

- Massive IT deployment capabilities.
- Well-functioning capital markets.
- Several success stories of large scale IT deployment in India: Example the Railways, the depository for stock markets.
- NSE and BSE, the two top stock exchanges in India are 3rd and 5th in the world as measured by the number of transactions.

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Part II

The NPS implementation

Problems of law

- Ideally: A law that created a regulatory capacity for the NPS
- 'PFRDA Bill'
- Opposition from left-leaning parties.
- Has not been passed.
- Solution: A set of private contracts between the government and various elements of the pension system.
- Implication: Political risk.

PFRDA

- The PFRDA acts as a regulator through an executive order till the bill is passed.
- Functions as an arm of the Ministry of Finance.
- Mandate: development and regulation of the pension sector in India.

What has PFRDA done

In the last thirteen months it has:

- Selected a central record-keeping agency (CRA)
- Selected Pension Fund Managers (PFMs)
- Set up a Trust called the NPS Trust under the Indian Trusts Act, 1882 to oversee the functions of the PFMs
- Appointed a custodian
- Appointed a Trustee Bank to facilitate flow of funds between the central government and the CRA
- Opened up the NPS to the informal sector

Central Record-keeping Agency (CRA)

- The National Securities Depository Limited (NSDL) was appointed as CRA on April 10, 2007.
- Selected through a competitive bidding process based on technical and commercial criteria.
- The CRA became operational on 1st June 2008.
- No capital investment by GoI for operationalization.
- Service charge model on the basis of *number of investors and transactions*.
- NSDL has committed to reduce charges as and when the number of subscribers cross 1 million and 3 million in the CRA system and hold this charge for ten years.

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Pension Fund Managers (PFMs)

- Three public sector PFMs chosen through a process of competitive bidding, based on technical capabilities and costs.
- These are the State Bank of India, UTI Asset Management Company Private Limited and Life Insurance Corporation of India.
- Provided a weighted average return of 11.88% between 2008-2010.
- AUM as of December 2010: US$ 1.6 billion.

With 1 million members and $1.6 billion in assets, NPS is starting to gain economies of scale.

Fumbling on execution

1. Problems of connecting up distributed payroll system of government into the NPS.
   Opportunity of riding on the Tax Information Network was blown.
2. At first PFRDA did a pooled fund management mechanism for employees of the central government.
3. Poor policy choices on asset allocation.
4. Framework of fund managers $\times$ asset classes was not done.
5. Lack of engagement between member and NPS.

NPS membership, October 2010

	Number
Central Government	670,843
Central Govt. Autonomous Bodies	11,621
State Governments	404,677
Outside of Government	18,367
Total	1,105,508
Source: PFRDA	

The membership should be 2x or 3x larger!

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Asset allocation

Instrument	Prescribed limit
Government Securities (Central & State)	Upto 55%
Corporate Bonds (PSU, Private corporate debt & Fixed deposit)	Upto 40%
Money market instruments (Includes units of money market mutual funds)	Upto 5%
Equity and equity related mutual funds	Upto 15%

Source: PFRDA

Costs

Head	Service Charges (US$)
Central Record-keeping Agency	
Account Opening	1.09
Annual maintenance	6
Charge per transaction	0.13
Points of Presence	
Initial subscriber registration	
& contribution upload	0.87
Any subsequent transaction	0.43
Trustee Bank	
Transaction from a RBI location	0
Transaction from a non-RBI location	0.33
Custodian	
Asset servicing charges	0.0075% p.a for Electronic segment
	0.05% p.a. for Physical segment
Pension Fund Management	
Investment Management Fee	0.0009% p.a.

Source: PFRDA

The NPS experience

- What worked:
  - NPS: A second generation DC system.
  - Focus on costs.
- What is yet lacking:
  - Execution capability.
  - Legislation
  - Choice between multiple managers and asset classes.
  - Full fledged integration of state government pensions into the NPS.
  - Transparency.

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Part III

Military pensions

Scheme benefits

- Defined-benefit, PAYG scheme financed by the Government of India.
- For commissioned officers, pension calculated at 50% of the average emoluments drawn during the last 10 months.
- Need to be in service for 20 years to be eligible
- Permitted commutation of pensions at 43%.
- For Personnel Below Officers Rank (PBOR), it is calculated with reference to the maximum of the scale of pay of the rank and group held for 10 months preceding retirement.
- Need to be in service for 15 years to be eligible.
- Permitted commutation of pensions at 45%.

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Expenditure on military pensions

	Amount in USD million			
Year	Army	Navy	Air-force	Total
2000-01	2,160	56	118	2,335
2009-10	4,359	153	317	4,830

Source: Expenditure Budget, Volume II
Defence Pensions, Government of India 2001-02 & 2009-10

Part IV

Next steps

Basics

- Stay on track on the basic approach of the NPS
- Build greater execution capability and policy capacity at PFRDA

Carrying through the civil service pension

- Round up every single new recruit after 1/1/2004!
- Good quality choices of asset classes, and ease of switching
- International diversification
- Polish the implementation
- Transparency

Immediate extensions

- Bring in the soldiers
- Voluntary switch out of DB on the part of civil servants recruited prior to 1/1/2004.

Future

- Can NPS play a rule in the reform of the mandatory pensions for the private sector?
- Voluntary participation by individuals more broadly?

Thank you.