FOREIGN INVESTMENT IN INDIA: OPENING OF PENSION SECTOR!

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1. The Indian government in continuation of its economic reforms decision has proposed the foreign direct investment ("**FDI**") to the extent of 49% in insurance sector[1] besides opening the pension sector[2] for FDI on par with the insurance sector. The Bills to implement these decisions will be moved in the next (winter) session of the Parliament.

2. BRIEF BACKGROUD OF INDIAN PENSION SECTOR[3]

2.1 In India, in the absence of a country-wide social security system formal pension coverage is being about 12% of the working population. The unorganized sector has no access to formal channels of old age economic support. More than 90% of work force work in unorganized sector and about 50% of India's national product are accounted for by unorganised sector.

2.2 The pension benefits of the Union government employees are covered under Central Civil Services (Pension) Rules 1972 and other related rules/schemes framed by the Union Government. However, the pensioners of Ministries of Railways and Defence are governed by their respective pension rules having their independent administrative set up. The employees of the State governments are covered by the pension rules of the State concerned. The employees working in the establishments belonging to the class of industries/ other establishment[4] listed in the schedule appended to Employees' Provident Fund and Miscellaneous Provisions Act 1952 are covered under Employees Provident Fund Scheme administered by Ministry of Labour. Further, the pension related matters of those who joined/would join the Union government on or after 1 January 2004, are dealt by Ministry of Finance under New Pension scheme as explained below.

2.3 There were series of budget announcements (starting from 2001-02) on the reforms in pension sector to ensure the social security in the unorganised sector and to cut down the fiscal stress of the defined benefit pension system applicable to employees in the organized public sector mainly the Government employees. The Indian government approved in August 2003 the proposal to implement the budget announcement of 2003-04 relating to introducing a new restructured defined contribution pension system for new entrants to central government service, except to Armed Forces, in the first stage, replacing the then existing system of defined benefit pension system. This new system was also available, on a voluntary basis, to all persons including self-employed professionals and others in the unorganised sector. Accordingly, the Indian government operationalized the New Pension System (NPS) from the 1 January 2004 through a notification dated 22 December 2003. The Indian government had also constituted an interim pension sector regulator named as 'The Interim Pension Fund Regulatory and Development Authority' through a Government Resolution in October 2003 as a precursor to a statutory regulator.

2.4 The Pension Fund Regulatory and Development Authority Bill 2005 ("**PFRDA Bill 2005**") was introduced in Lok Sabha (lower house of the Parliament) in March 2005 to establish a statutory Pension Fund Regulatory and Development Authority. The PFRDA Bill 2005 was referred to the then Standing Committee on Finance on the 24 March, 2005 for examination and report thereon. The then Standing Committee on Finance gave its Report on 26 July 2005. The Government proposed official amendments in January 2009 to give effect to certain recommendations of the then Standing Committee on Finance but the

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[1] http://pib.nic.in/newsite/PrintRelease.aspx?relid=88163

[2] http://pib.nic.in/newsite/PrintRelease.aspx?relid=88162

[3] 40th Report dated 29 August 2012 of Standing Committee on Finance on the Pension Fund Regulatory and Development Authority Bill, 2011

[4] http://www.epfindia.nic.in/class_industries.htm

official amendments could not be moved and the PFRDA Bill 2005 was not passed and the same lapsed due to dissolution of the 14th Lok Sabha.

2.5 An early legislative mandate was considered necessary as the NPS was already in place without the statutory regulatory mechanism. However, pending the passage of the PFRDA Bill 2005, the Interim Pension Fund Regulatory and Development Authority has created the institutional arrangement of NPS Trust, central recordkeeping agency, pension fund and a trustee bank. Notably, 27 State Governments and Union territories have adopted the NPS for their employees and are in the process of extending the NPS to their employees. Sixteen State Governments have already joined the NPS institutional architecture. Further, to encourage people from the unorganised sector to voluntarily save for their retirement, the Indian government has launched the co-contributory pension scheme titled "Swavalamban Scheme" in the Union Budget of 2010-11. As on 7 September 2012, the number of subscribers under NPS is 3.745 million with a corpus of INR 205.35 billion.

2.6 In view of the urgency of the matter, the Pension Fund Regulatory and Development Authority Bill 2011 ("**PFRDA Bill**") was being introduced in Parliament on 24 March 2011 to provide for the establishment of a statutory Pension Fund Regulatory and Development Authority to promote old age income security by establishing, developing and regulating pension funds, to protect the interests of subscribers of various pension fund schemes and for matters connected therewith or incidental thereto. The PFRDA Bill was referred to the Standing Committee on Finance on 29 March 2011 for examination and the said committee submitted its report on 29 August 2012.

3. SALIENT FEATURES OF PFRDA BILL

(a) Establishing a statutory regulatory body to be called the Pension Fund Regulatory and Development Authority ("**PFRDA**") which will undertake promotional, developmental and regulatory functions in respect of pension funds.
(b) Empowering the PFRDA to regulate the National Pension System ("**NPS**"), as amended from time to time.
(c) Empowering the PFRDA to perform promotional, developmental and regulatory functions relating to pension funds (including authorising and regulating intermediaries) through regulations or guidelines, prescribing the disclosure standards, protecting the interests of subscribers to schemes of pension funds.
(d) Authorising the PFRDA to levy fees for services rendered, etc., to meet its expenses.
(e) Empowering the PFRDA to impose penalties for any violation of the provisions of the PFDRA Bill (when it becomes law) and rules, regulations, etc. to be issued thereunder.
(f) To establish a vibrant pension advisory committee with representation from all major stakeholders to advise the PFRDA on important matters of framing of regulations under the PFRDA Bill.
(g) Registration of all intermediaries operating in pension sector.
(h) The membership of the PFRDA will be confined to professionals having expertise in economics, finance or law only.
(i) FDI upto 26% or such percentage as may be approved for the insurance sector, whichever is higher, may be incorporated in the PFRDA Bill. Thus if insurance bill passes with 49% FDI, the pension sector will automatically have 49% FDI.

4. NEED FOR FDI IN PENSION SECTOR

4.1 In the "Approach Paper to Twelfth Five Year Plan[5] of Planning Commission of India, on 'Financing Private Investment' stated that "since more than two-thirds of the investment in

[5] http://planningcommission.gov.in/plans/planrel/12appdrft/appraoch_12plan.pdf

the economy is by private sector (households and corporate), it is necessary to ensure that the financial system is able to translate the otherwise favourable macroeconomic investment-savings balances into effective financing of the private sector investment needed for 9% GDP growth. For this, we need a financial system capable of mobilising household savings and allocating them efficiently to meet the equity and debt needs of the fast expanding private corporate sector. This depends upon the efficiency of the financial system as a whole, which at present consists of a large number of financial institutions, such as banks, non-bank finance companies, mutual funds, insurance companies, pension funds, private equity firms, venture capital funds, angel investors, micro-finance institutions etc."

4.2 It was emphasized in this Approach Paper that "special attention must be paid to the financing needs of private sector investment in infrastructure. Infrastructure investment (defined as electricity, roads and bridges, telecommunications, railways, irrigation, water supply and sanitation, ports, airports, storage and oil-gas pipelines) will need to increase from about 8%nt of GDP in the base year (2011-12) of the Plan to about 10% of GDP in 2016-17. The total investment in infrastructure would have to be over US$ 1 trillion during the Twelfth Plan period. Financing this level of investment will require larger outlays from the public sector, but this has to be coupled with a more than proportional rise in private investment. Private and PPP investments are estimated to have accounted for a little over 30% of total investment in infrastructure in the Eleventh Plan. Their share may have to rise to 50% in the Twelfth Plan."

4.3 Some important steps that need to be taken in the Twelfth Plan period as suggested in this Approach paper includes reforms in pending pension and insurance sectors on a fast-track basis. Mutual funds, insurance and pension funds are not only efficient routes through which household savings can be mobilised for corporate investment, but also vehicles that provide financial security to a large section of our population, hitherto excluded from the benefits of modern financial services.

4.4 Notably, pension sector is a capital intensive industry and requires huge capital with long gestation period. In view of above, it was considered necessary to allow the FDI inflows to meeting the capital requirements in pension sector that will ultimately help in efficient mobilization of the household savings for corporate investment and to support the infrastructure sector on long term basis. However, appropriate provisions are to be made to limit the restrictions on the pension funds enabling them to participate in infrastructure projects as discussed in above.

5. BENEFIT OF FDI IN PENSION SECTOR

5.1 The study of ASSOCHAM on FDI in Pension Sector[6] observed that the Organization for Economic Cooperation and Development countries account for more than 90% of the world's private pension assets and the USA account for nearly half of the total assets of private pension assets. Pension fund assets in BRIC countries are relatively low in relation to their GDP, i.e., 17% in Brazil, 2% in Russia, 5% in India and 1% in China. Allowing FDI in pension sector would give access to global pension fund companies to the vast untapped Indian market. Assuming that opening up of FDI in pension funds shall help India in attracting slightly more than 1% of the total pension funds held by pension fund companies India would be able to raise the share of pension fund assets to GDP from the current level of 5% to close to 17% which would be similar to that of Brazil's 2010 level.

5.2 Moreover, 2.1% allocation of total pension fund assets to India would increase its reserves to US$ 342 billion (equal to pension assets of Brazil in 2010). If pension funds reach 17% of India's GDP, then this would result in assets worth US$ 165.85 Billion. In such a scenario,

[6] http://www.assocham.org/arb/general/Indias_Experience_with_FDI_Role_of_a_Game_Changer.pdf

going by the world trends the equity allocation (47%) of the pension fund assets (47% of US$ 342 billion) alone could be as high as US$ 160 billion. A compounded annual growth rate of 16.5% (as witnessed by Brazil) would result in total pension assets of US$ 733.93 billion at the end of 2017 of which equity would be US$ 344.95 billion (47% of US$ 733.93 billion). If 30% of this equity allocation goes into infrastructure sector, it would mean an investment of US $ 103.49 billion which is close to one tenth of the infrastructure investment requirement of the Twelfth Five Year Plan.

5.3 In addition to the above, the other benefits of FDI and PFRDA Bill are as under:

(a) Availability of pure pension products to those employed in the private sector as currently most pension plans are insurance-linked;

(b) Entry of international market players will bring specialised products and services in the pension industry to make it more competitive and consumer friendly; and

(c) Less fiscal stress on the Union and State Governments.

6. OPPORTUNITIES FOR FOREIGN INVESTOR IN PENSION SECTOR

As per para 6 of statement of objects and reasons of the PFRDA Bill, FDI for pension sector intermediaries including the pension funds[7] and central recordkeeping agency[8] would be determined and notified outside the proposed legislation under the Foreign Exchange Management Act, 1999. As per clause 2(g) of the PFRDA Bill "intermediary includes pension fund, central recordkeeping agency, National Pension System Trust[9], pension fund adviser[10], retirement adviser[11], point of presence[12] and such other person or entity connected with collection, management, recordkeeping and distribution of accumulations. Also in Press Release dated 4 October 2012, there is no specific reference to the activities in which FDI will be allowed. Therefore, one has to wait for the proposed regulation to be issued by the Indian government in this regard.

7. CONCLUDING REMARKS

The decision to opening the pension sector for FDI is widely welcomed by the business associations like FICCI, ASSOCHAM and CII for the reasons discussed above. It is expected that PFRDA Bill will become a law in next session of Parliament without much political hurdle as the major opposition party is also apparently supporting the PFRDA Bill and is presently asking the Indian government to ensure sovereign guarantee of the pension fund for minimum returns of should not be less than the rate of interest on the Employees Provident Fund Scheme should not be less than the rate of interest (presently 8.25%) on the Employees Provident Fund Scheme[13], protection of labour interest and security of the pension fund itself[14] and such issues in some way or other will be taken care by the Indian government.

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[7] Clause 2(l) of PFRDA Bill - "Pension Fund" means an intermediary which has been granted a certificate of registration under sub-section (*3*) of section 26 by the Authority as a pension fund for receiving contributions, accumulating them and making payments to the subscriber in the manner as may be specified by regulations.

[8] Clause 2(b) of PFRDA Bill - "Central Recordkeeping Agency" means an agency registered under section 26 to perform the functions of recordkeeping, accounting, administration and customer service for subscribers to schemes.

[9] Clause 2(j) of PFRDA Bill - "National Pension System Trust" means the Board of Trustees who hold the assets of subscribers for their benefit.

[10] Not defined in PFRDA Bill.

[11] Not defined in PFRDA Bill.

[12] Clause 2(n) of PFRDA Bill - "Point Of Presence" means an intermediary registered with the Authority under sub-section (*3*) of section 26 as a point of presence and capable of electronic connectivity with the central recordkeeping agency for the purposes of receiving and transmitting funds and instructions and pay out of funds.

[13] Framed under the Employees' Provident Fund and Miscellaneous Provisions Act 1952.

[14] http://www.dnaindia.com/india/report_bjp-wants-conditions-for-fdi-in-insurance-pension_1748949

8. ABOUT THE AUTHORS

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