Chapter - I

Introduction
CHAPTER I

1.1 INTRODUCTION

Pension is very important for senior citizens to maintain and improve their quality of life, through greater independence in their decisions, improved status in the family and greater self-confidence.

When people do not enjoy a regular and steady source of income, it becomes more significant to have a pension plan handy. A standard retirement plan serves to ensure that individuals can sustain their life standards without being dependent on others and without having to compromise on their standard of life during their post retirement period.

Government has the sole responsibility to formulate and implement public policy on population ageing. The majority of working population in India expects to have better quality of life at least to maintain the current living standards after retirement. This is the prime reason why pension plans today account for around 39 per cent of insurance industry’s total business.¹

In the Constitution of India, entry 24 in list III of schedule VII deals with the “Welfare of Labour, including conditions of work, provident funds, liability for workmen’s compensation, old age pension and maternity benefits. In Directive Principles, Article 41 of the Constitution of India directs the State to provide public assistance to its citizens in case of unemployment, old age, sickness and disablement

¹ Mahler India Growth Fund, Pension System And Management in India, Global asset management, Netherlands, 2011.p. 6.
and in other cases of underserved want within the limit of its economic capacity and development.²

**SOCIAL SECURITY**

Social security protects not just the subscriber but also his/her family by giving benefit packages in financial security and health care. Social Security Schemes (SSS) are designed to guarantee at least long-term sustenance to families when the earning member retires, dies or suffers a disability. Thus the main strength of the social security system is that it acts as a facilitator; it helps people to plan their own future through insurance and assistance. The success of social security schemes however requires the active support and involvement of employees and employers. A worker/employee is a source of social security protection for him and his family. An employer is responsible for providing adequate social security coverage to all their workers.³

India always has Joint Family system that took care of the social security needs of all the members provided it has access/ownership of material assets like land. Cultural traditions, family members and relatives have always discharged a sense of shared responsibility towards one another. To the extent that the family has resources to draw upon, this is often the best relief for the special needs and care required by the aged and those in poor health.⁴

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² Ibid.
⁴ Ibid.
FINANCIAL LITERACY

Financial knowledge has been defined as the ability to make informed judgments and effective decisions regarding the use and management of money (Worthington, 2005). Remund (2010) on the other hand defines it as a measure of understanding key financial concepts. Financial knowledge enables individuals to build their financial skills and gives them confidence to undertake financial decisions for their pension schemes. Knowledge on saving plans is critical for effective long-term financial decision (Landerretche & Martinez, 2011). Households with low financial knowledge do not plan well and so they have lower retirement savings, shorter planning horizons and are less likely to contribute to pension funds than those with the requisite knowledge (Mitchell & Mutkus, 2003; Lusardi, 2006). Financial knowledge is directly correlated with self-beneficial financial behaviour and without it individuals will most likely have problems with debt, not save, engage in exorbitant mortgages and will not plan for retirement. Financial knowledge has been found to have a strong positive relationship to individual’s involvement in pension matters (Moore, 2003), understanding of rights and obligations in pension schemes (Choi et al, 2005), sharpening the risk attitude (Agnew & Szykman, 2005), increasing savings and investments in complex assets (Lusardi & Mitchell, 2006) and enhancing innovative ideas (Calvert, Campbell & Sodini, 2005). Low level of knowledge is associated with limited success of voluntary savings schemes, for instance, program impacts negatively on the general savings culture and low awareness on pension matters (Reserve Bank of Australia (RBA), 2007).  

CURRENT PENSION PLANS IN INDIA

Civil Servants’ Pension (CSP): CSP is a traditional defined benefit scheme which runs on the basis of pay-as-you-go system, for employees of Central Government who were recruited up to 31st December, 2003 and employees of State Governments recruited up to the effective date mentioned in notifications issued by those governments. There has been no attempt at building up pension assets through contribution or any other provision in CPS. CSP scheme is indexed to wages and inflation. A modified one rank one-wage principle applies to it wherein all retired employees of a certain rank get the same pension. Pension payments are revised periodically to reflect the growth in wages and consumer price index. Growth in pension benefits in old age is typically higher than inflation.6

Employees Provident Fund (EPF): The EPF Scheme is an individual account defined contribution scheme wherein both the employee and employer contribute to the fund at the rate of 12 per cent of the employee’s pay. There are a number of provisions under the scheme for pre-mature withdrawal of accumulation. This pre-mature withdrawal provision is frequently used by the members of the scheme which leads to small balances at the time of their superannuation. Because of low balance in individual account of the members, old age income benefit is negligible. The EPF scheme enjoys an Exempt Exempt Tax (EET) structure which constitutes a major tax based subsidy.7

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Employees’ Pension Scheme (EPS): The EPS is a defined benefit scheme, based on a contribution rate of 8.33 per cent from the employee to which government makes an additional contribution of 1.16 per cent. EPS was introduced in 1995 and is applicable to the workers who entered into employment after 1995. In case of death of a member the scheme provides for a pension to the spouse for his/her remaining life.⁸

There are other voluntary pension schemes available for general public but these schemes cover a very small segment of the total population. Life Insurance Companies and Mutual funds are offering these plans. These are essentially defined contribution schemes. Personal Pension Plans and Group Pension Products offered by the life insurers are being supervised by the Insurance Regulatory and Development Authority (IRDA). Schemes offered by the Mutual Funds are regulated/supervised by the Security Exchange Board of India (SEBI). Tax benefits up to a specific amount are being offered to investors buying these pension plans. Total coverage under these pension plans is about 1.6 million.⁹

The other popular scheme is Public Provident Fund (PPF) which is also a defined contribution scheme. Government is managing this scheme. A fixed rate of return is offered under the scheme. In addition, tax benefits are being offered for making investment in the Public Provident Fund account. Coverage under the Public Provident Fund is about 3.5 million.¹⁰

In 2001, Government of India appointed a group of experts to study the various aspects of extending an organised system of pension to the unorganised sector. The group submitted its report in October 2001. According to this report, the

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⁸ Ibid., p. 8.
⁹ Ibid., p. 12.
¹⁰ Ibid., p. 13.
pension market (which includes pensions, provident funds and other small savings i.e. National Saving Certificate (NSC), National Service Scheme (NSS)) would grow to about Rs.4064 billion by 2025. The growth would largely be due to normal growth of economy in terms of growth in income and population and does not consider the significant increase in coverage that would arise because of reforms in the insurance and pension sectors. A more conservative estimate is that the pension market will be worth about Rs.1808 billion by 2025.\textsuperscript{11}

\textbf{NATIONAL PENSION SCHEME (NPS)}

The National Pension Scheme introduced by the Government of India is South Asia's first Defined Contribution (DC) pension scheme with individual retirement accounts, product choices, professional fund management by competing fund managers and portability through centralised record keeping and administration. The NPS is an attempt to move away from the defined benefit pension plans to defined contribution based schemes. But, this change would be applicable only to the new entrants. The idea behind pension plan is to provide financial security and stability to individuals during the later stages in life. It is applicable to all Central Government Employees who joined on or after 01–01–2004. Under the NPS, every subscriber will have an individual pension account, which will be portable across job changes. The subscribers can choose fund managers and schemes to manage their pension wealth. They may also have the option of switching schemes and fund managers. NPS has been extended to all citizens of India with effect from 1\textsuperscript{st} May 2009. Tamil Nadu state is the first state to introduce (6.8.2003) the contributory pension system in India.\textsuperscript{12}

\textsuperscript{11} Ibid., p.15.
\textsuperscript{12} Ibid., p. 23.
This research explores some of the unanswered important questions about national pension system that can be examined and investigated. It also explains the factors responsible for the unusual movements in net asset value, which could not be fully explained by the theories of traditional finance. This study examines their important attitudes displayed by the pension subscribers in new pension system. They are: ‘financial literacy’ towards national pension system'; ‘Expectations’ those subscribers have about the future performance of the net asset value in national pension scheme in India; ‘expected rate of return’ that pension subscribers have regarding their pension investments; and ‘Satisfaction level’. Present study also analyses the pension investors’ preference towards national pension system.

1.2 STATEMENT OF THE PROBLEM

Nowadays, pension schemes have been spread and have been established around the globe, in both developed and developing countries. Though the type of pension scheme varies, all play an important role in providing necessary income to elderly populations and in alleviating post-retirement poverty among the poorest sectors of the society.

As the number of joint families on the decline in India, post retirement planning is a must to have a tension-free and independent life. Pension plans prove to be of great help as one can maintain and continue living the life he had prior to retirement. To get maximum benefit and live a tension free life in the post-retirement phase, one needs to plan early for a pension plan. As the terms and conditions of pension plans are complicated, financial literacy about post-retirement life can solve most of the problems.
There has been a lot of talk in the media about retirement insecurity. Retirement Security provides a guaranteed, cost-of-living adjusted income for life in retirement. Best approach in achieving retirement security consists of a pension and individual savings. Pension helps a person to maintain standard of living and retirement savings provides important supplemental income for unforeseen expenses.

In recent years, the concern for social security is deeply influencing the social and economic policy of the developed as well as the developing countries. The concept of social security is that the State should make itself responsible for ensuring a minimum standard of material welfare to all its citizens. The basic social security system aims to help individuals in times of dependency, such as, childhood, old age, sickness, accident and unemployment. Pension is one of the important factors to determine the social security conditions of the old age people. Pension finance literacy enables individuals to plan for retirement, make proper choices on pension products and contribute effectively in management of their pension schemes.

This study has been made to analyse the national pension scheme in India by providing overall bird’s eye view of pension subscribers’ social security conditions, their literacy level, perception and satisfaction level concerning national pension scheme, based on information collected from pension subscribers (central, state and private concern employees) of four districts in Tamil Nadu.
1.3 OBJECTIVES OF THE STUDY

1. To study the socio-economic profile of the sample contributors of National Pension Scheme;

2. To ascertain the respondents’ social security conditions;

3. To evaluate the financial literacy level of the respondents concerning National Pension Scheme;

4. To analyse the respondents’ perception about National Pension Scheme and

5. To ascertain the level of satisfaction concerning National Pension Scheme.

1.4 SCOPE OF THE STUDY

The study attempts to describe the social security conditions, financial literacy and perception and satisfaction level of the subscribers concerning NPS. The study covers the social security conditions of selected pension subscribers from central, state and private concern employees who joined on or after 1st January 2004 in national pension scheme, their financial literacy about national pension scheme, perception about national pension scheme and satisfaction level concerning national pension scheme.
1.5 RESEARCH METHODOLOGY

Methodology is the key aspect which governs the outcome of the research. It encompasses and directs the researcher to conduct the research in a systematic process which ensures and facilitates the accuracy of the outcomes.

The methodology deals with the population of the study, method of data collection, pilot study and pre testing, sampling plan, sample size, technique of data collection, types of data used for the research, hypotheses, and statistical tools applied.

AREA OF THE STUDY

The study was conducted in four districts of south India of Tamil Nadu namely Chennai, Madurai, Coimbatore and Tiruchirappalli.

These four districts are the main cities of the State of Tamil Nadu.

1 - Chennai; 2 - Thiruchirappalli; 3 - Madurai; 4 – Coimbatore

Chennai: Chennai district is the smallest of all the districts in the state, but has the highest human density. It covers an area of 178.20 sq. kms situated on the north eastern corner of Tamil Nadu. This district has a population of 46,46,732 as per census 2011. The district is a city district which means that it does not have a district headquarters. Chennai, besides being the capital city of Tamil Nadu is also an important district of the state. The district is located on the north-east end of Tamil
Nadu on the coast of Bay of Bengal. Surrounded by the Bay of Bengal in the east and the remaining three sides by Chengalpattu and Thiruvallur Districts, Chennai has an even topography of land with slight rises from the sea level. The district city is important for various aspects. It is the political, cultural and educational heart of Tamil Nadu.

**Thiruchirappalli:** Thiruchirappalli district is one of the 32 districts in Tamil Nadu. The district occupies an area of 4,403.83 km. This district has a population of 27,22,929 as per census 2011. It is the fourth largest municipal corporation and the fourth largest urban agglomeration in the state. Tiruchirappalli is situated in central south-eastern India, almost at the geographic centre of the state of Tamil Nadu. The city had an average literacy rate of 88.71 per cent as per census 2011.

**Madurai:** Madurai is the administrative headquarters of Madurai district in the Tamil Nadu. Madurai is the second corporation in Tamil Nadu next to Chennai corporation. The city covers an area of 3742.73 sq. km and had a population of 30,38,252 as per 2011 census. The literacy rate was 87 per cent.

**Coimbatore:** Coimbatore is situated in the west of Tamil Nadu. It covers an area of 7,469 sq. km. The district has a population of 34,58,045. Coimbatore is the second largest city and urban agglomeration in the Indian state of Tamil Nadu, after Chennai and the sixteenth largest urban agglomeration of India. It is one of the fastest growing tier-II cities in India and a major textile, industrial, commercial, educational, information technology, healthcare and manufacturing hub of Tamil Nadu. Coimbatore is the fourth largest metropolis in South India. Coimbatore has an average literacy rate of 89.23 per cent.
POPsULATION OF THE STUDY

The population of the study constitutes pension contributors in National Pension Scheme (NPS) among the four districts namely Chennai, Tiruchirappalli, Madurai and Coimbatore of the state of Tamil Nadu in India. It includes employees of various departments of Central Government, State Government and Private concerns which are located in the four districts of Tamil Nadu.

TYPES OF DATA USED FOR THE RESEARCH

In this study both primary data and secondary data have been used based on objectives of the study. Primary data were collected through structured questionnaire. The secondary data were collected from various sources such as journals, books, magazines, newspapers, websites and from previous studies.

METHOD OF DATA COLLECTION

Sample survey method has been used to collect the primary data. The sampling technique used is quota sampling. The data were collected from the central, state and private concern employees of four districts namely Chennai, Madurai, Coimbatore and Trichy in Tamil Nadu.

SAMPLING PLAN

Sampling is simply the process of learning about the population on the basis of a sample drawn from it. In sampling technique instead of every unit of the universe only a part of the universe is studied and conclusions are drawn on that basis for the
entire universe.\textsuperscript{13} Since the population of the selected location for the research is very large, only selected samples have been taken up for the study.

**SAMPLE SIZE**

384 samples were determined as sample size from the following formula suggested by Godden (2004):

\[
SS = \frac{z^2 p(1 - p)}{C^2}
\]

\[
SS = \frac{(1.96)^2 0.5(1 - 0.5)}{(0.05)^2}
\]

\[
= 384
\]

Where,

SS = Sample Size

Z = Z-value (e.g., 1.96 for a 95 per cent confidence level)

p = Percentage of population picking a choice, expressed as decimal (max=0.5)

C = Confidence interval, expressed as decimal (e.g., .05 = +/- 5 percentage points)

\textsuperscript{13} Prof. Shardp Kamra, Research Methodology, Hyderabad, ICFAI, April, 2004, p.6.
SAMPLE DISTRIBUTION

The 384 samples were distributed according to the per cent of Central, State and Private pension subscribers out of the total NPS subscribers.

Table 1.1 Population and sample size

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Employer/Sector</th>
<th>Population (%)*</th>
<th>Sample (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Central Government</td>
<td>10,90,697 (61)</td>
<td>236 (61)</td>
</tr>
<tr>
<td>2.</td>
<td>State Government</td>
<td>3,75,486 (21)</td>
<td>79 (21)</td>
</tr>
<tr>
<td>3.</td>
<td>Private Sector</td>
<td>3,21,845 (18)</td>
<td>69 (18)</td>
</tr>
<tr>
<td></td>
<td><strong>Total subscribers</strong></td>
<td><strong>17,88,028 (100)</strong></td>
<td><strong>384 (100)</strong></td>
</tr>
</tbody>
</table>

* Source: www.pfrda.org.in

TECHNIQUE OF DATA COLLECTION

The primary data required for the study were collected through a structured questionnaire. The questionnaire contains four parts. The first part deals with socio-economic profile of pension subscribers. The second part relates to social security conditions including their wealth, per cent of saving, investment pattern etc., of the respondents. The third part explores their financial literacy or awareness on National Pension Scheme. The fourth part deals with their perception and satisfaction level concerning National Pension Scheme.
VARIABLES USED IN THE STUDY

**Dependent Variable (DV):** Financial Literacy level, social security conditions, perception and satisfaction concerning NPS.

**Independent Variable (IV):** Demographic characters of the respondents.

FORMULATION OF HYPOTHESES

The following hypotheses were framed in this study:

**Hypothesis 1**

a) There is no relationship between demographic character of the respondents and social security conditions.

b) There is no significant difference in ranking of the ‘savings schemes for old age social security’ by the respondents.

c) There is no significant difference in ranking of the needs for the savings for the old age by the respondents.

*(Tests: Independent sample t-test, one way ANOVA, Duncan and Games-Howell Post hoc test, Karl Pearson correlation and Friedman’s test)*
Hypothesis 2

a) There is no significant difference among respondents of different socio-economic profile with regard to their overall financial literacy level concerning NPS.

b) There is no correlation between demographic character of the respondents and overall financial literacy level concerning NPS.

*(Tests: Independent sample t-test, one way ANOVA, Duncan Post hoc test and Karl Pearson correlation)*

Hypothesis 3

a) There is no significant difference in expected rate of return from NPS based on socio economic profile of respondents.

b) There is no correlation between percentage of saving of the respondents and expected rate of return.

c) There is no correlation between financial literacy level of respondents and their expected rate of return.

*(Tests: Independent sample t-test, one way ANOVA, Duncan and Games-Howell Post hoc test and Karl Pearson correlation)*

Hypothesis 4

a) There is no significant association between socio economic profile of respondents and the overall satisfaction level concerning NPS.

*(Test: Chi-square test)*
PILOT STUDY

A pilot study was undertaken to collect preliminary information about individual investors’ behaviour. Based on the pilot study of 40 respondents, the questions were checked as to whether they relate to objectives and the feasibility, validity and reliability of the variables contained in the questionnaire were confirmed. Based on the feedback given by the respondents, necessary changes were incorporated in the questionnaire.

STATISTICAL TOOLS APPLIED

The primary data collected from the respondents from different districts have been properly sorted, classified, edited, tabulated in proper format and analysed by deploying appropriate statistical tools. The researcher used Statistical Package for Social Sciences (SPSS), in order to analyse the data. The following statistical tools were used for analysing the data collected from the respondents from different locations selected for the study.

i. Percentage analysis

ii. Chi-Square Test

iii. Friedman’s test

iv. T-test

v. ANOVA

vi. Duncan and Games-Howell Post hoc multiple comparison test and

vii. Correlation
1.6 OPERATIONAL DEFINITIONS

**Annuity:** A form of financial contract mostly sold by life insurance companies that guarantees a fixed or variable payments of income benefits (monthly, quarterly, half-yearly, or yearly) for the life of a person(s) for a specified period of time. An annuity may be bought through instalments or as a single lump sum payment.

**Asset Allocation:** Asset allocation refers to diversification of portfolio among different asset class in order to minimise risks and maximise risk adjustment, etc.

**Bonds:** Bonds are fixed income securities also known as debt instruments created to raise capital.

**Central Record keeping Agency (CRA):** It performs some core activities in NPS such as record keeping, administration and customer service functions for all subscribers of the NPS.

**Defined Benefit (DB) Scheme:** DB scheme/plans are unfunded pension scheme with predetermined pension benefits. The benefits are determined by a special formulation and pensions are usually paid at a certain percentage of terminal (at the time of retirement) salary of an employee.

**Defined Contribution (DC) Scheme:** DC scheme/plans are also called Money Purchase Scheme and are fully funded pension scheme. The benefits under DC scheme are not pre-determined. In DC scheme entire investment and mortality risks are transferred to the members (investor).

**Dependency Ratio:** Dependency Ratio is the ratio of dependent persons (generally under age 15 and over 60 years of age) to the working age population (normally age group between 15 and 60 years).

**EET system:** Exempt – Exempt – Tax (EET) is a form of taxation imposed on pension plans, under the EET, contribution, investment income, capital gains of the
pension fund are tax exempt but benefits are taxed at the time of exit from the scheme.

**ETE system:** Under ETE (Exempt – Tax – Exempt) contribution to pension fund and benefits are tax exempt but investment income and capital gains of the pension fund are taxed.

**EEE system:** under EEE (Exempt – Exempt – Exempt) system, contribution, investment income and benefits are tax exempted.

**PFRDA:** Pension Fund Regulatory and Development Authority (PFRDA), is the prudential Regulator for NPS which was established by the Government of India.

**PFMs:** Pension Fund Managers (PFMs) are appointed by the PFRDA to manage pension funds under the NPS schemes.

**POP:** Point of Presence are authorised by PFRDA to collect application forms from the subscribers to NPS scheme for onward transmission to central record keeping agency.

**Portability:** Ability to transfer individual pension account from one fund manager to another fund manager.

**PRAN:** Permanent Retirement Account Number provided to every member (Subscriber) of NPS.

1.7 LIMITATIONS OF THE STUDY

This study has the following limitations:

1. This study does not cover individual subscribers in national pension system of Lite scheme.

2. The data were collected from the respondents belonging to four major districts of Tamil Nadu.
1.8 CHAPTER ARRANGEMENT

The whole work has been divided into five chapters:

**Chapter I** gives as an introduction of the research. It discusses the background of the study, statement of the problem, objectives, scope, methodology, hypotheses, limitations and chapter arrangement.

**Chapter II** gives a review of literature which presents information from earlier studies made.

**Chapter III** presents a brief profile of the National Pension Scheme.

**Chapter IV** presents the analysis and interpretation of data collected.

**Chapter V** presents the summary of findings, suggestions, scope for further research and conclusion of the study.