CHAPTER- 2

INSURANCE AND PENSION: REFORMATION TOWARDS THE PRIVATIZATION AND GLOBALIZATION

1. Introductory Outline

It is not gainsaying that the constitution is the fundamental law of the land and operate for the most of the matters at the national level. The constitutional method has been chosen by India to eradicate the social inequalities and exploitation. The framer of Indian constitution in its preamble declared that the citizens shall be secured:

*Justice, social, economic and political, liberty of though, expression, belief, faith and warship... and to promote among them all, fraternity assuring the dignity of the individual and the nation*¹

But now a day's emphasis is being shifted from social justice towards the economic development. To achieve the economic development, reformation in the policy perspective of insurance and pension is necessary because these two sectors are core of economy. In this respect India adopted the World Bank inspired “Structural Adjustment Policy” which insist India towards the policy of privatization.

Privatization in the field of insurance and pension sectors is a measurement resulting in transfer of ownership to control over the assets or activities from the public to the private sector. In broad terms the privatization of insurance and pension encompasses involvement of greater marked forces to ensure higher competition and to reduced the role of the government in the economic sphere and thus bring the greater private involvement to the government activities. It refers to the liberalization of different regulations to unleash forces of competition to include market forces into the economy.
On the line of the policy of privatization of insurance and pension, the Indian new economic policy required that the Indian government to cut spending in the social programs and sell off the more profitable public enterprises at a good price to the larger business houses as well as to the foreign entities. It also require the liberalization of service sector, free entry of foreign capital, major reforms in banking, financial institutions and the tax structure of the country. 2

To achieve the objectives lay down by the India’s new economic policy, the government of India constituted R.N. Malhotra Committee and the Mukherji Committee for the guidance to reform the insurance sector. Again the government of India constituted Old Age Social and Income Security Committee and Bhattacharya Committee for the guidance to reforms the pension sector. These committees give their recommendation in favor of the privatization of both insurance and pension sector. After that, the policy of privatization was implemented by the government through the passage of IRDA Act 1999 and PFRDA Bill 2005. Than a lot of changes come in the insurance market such as dearth of product innovation, multi channel distribution system, competition among the market forces, consumer awareness etc. But the changes in the pension sector come in near future because the privatization in this sector is in premature stage, now only discussion is continuing.

2. Insurance: Reformation towards the Privatization and Globalization

The reformation towards the privatization and globalization is defines in the following heads-

1. The Existing Indian Insurance System and its Difficulties

The Indian does not have proper system of insurance as well as income security. There are however some schemes, among them some are mandatory
and some are voluntarily. These schemes are for central govt. / state government employee, employee of bank as well as employee of firm.

The existing Indian insurance system divided under the few categories which are as follows-

1. **Insurance Schemes in the Formal Sector**

   The insurance schemes under formal sector are further divided under few categories-

   1.1. **Insurance Schemes in the Statutory Framework**

      These schemes are also divided under two categories, which as follows-

   1. **Provident Fund and Employee State Insurance Schemes**

      These schemes introduce under the guidance of statutory framework and are contributory in nature. These schemes are managed by the Provident Fund Organization vis a vis Employee State Insurance Corporation. In these schemes the employer, employee as well as the govt. contribute to the incorporated fund, the benefit of which given to the employees at their requirement.

      But the so many difficulties are facing in the implementation and administration of these schemes because the policies and process of EPFO with ESIC was established in 1950. The transformations in technology and knowledge about insurance economics that have come about in the following years have not been reflected in a corresponding transformation in policies and process. There is much weakness in the mechanisms of fund management, operational procedures, transparency and governance which effecting to the working class.

   2. **Group Insurance Schemes**

      There are a lot of voluntarily group insurance schemes. These schemes manage privately by the manager appointed by the employer of insurance corp. In these schemes the employee invests the fund and purchases the annuities
from the LIC, and receives benefit at their requirement, under guidance of LIC Act, 1956.

But the value of annuity embedded in these schemes has gone up dramatically, no data about these schemes available in public domain.

1.2. Insurance Schemes in the Government Regulations

These schemes are also divided under few categories, which are as follows –

1. Schemes Introduce by the Central Government Regulations

These are also so many insurance scheme introduce by central govt. into which employee pay a small monthly premium determined according to service rank. In return, these schemes provide a survivor benefit equal to a multiple of the monthly premium in the event of worker dies prior to retirement as well as provides a lump-sum payment equal to accumulated premiums upon retirement. The employee also receive a lump sum gratuity based on final salary and years of service, with the facility of early withdrawals from their accumulated premium for specified purposes such as housing costs, marriage costs, education costs etc.

But the basic structure of these schemes is also questionable because these schemes increasing fiscal stress of govt.

2. Schemes Introduce by the State Government Regulations

The insurance schemes as introduce by centre, on the same pattern the insurance schemes have been laid down by the concerned state government. In these schemes employee contributes of their income, these schemes provide different kind of benefits such as survival benefit, retirement benefit, gratuity benefit etc.
But the problems regarding regulatory mechanism are also facing at state level, as are at central level by which fiscal stress of state govt. is increasing.

2. **Insurance Scheme in the Informal Sectors**

The poor and old age people are target of the government in the unorganized sector. Both the central and state government also provide scheme of insurance for these sector, but these scheme are not satisfying the need of the people. There must be some more concern of the government regarding insurance schemes because there are no mandatory insurance having programmed for the self employed workers. Although these workers are ineligible to join the EPF, even only on voluntary basis, they can join the PPF. The PPF has not been marked aggressively, and net collections have grown slowly.

3. **Insurance Schemes in the Governmental Organization**

The government organization includes insurance companies (LIC, GIC), bank (SBI), Electricity Board, Oil and Natural Gas Corporation vis a vis public sector undertaking. They provide a lot of schemes of insurance in the matter of disability, hospitalization, accident, pension and gratuity. These bodies itself manage these schemes and little guidance taken from IRDA.

But the problems are still facing by the people in respect of these schemes because these bodies becoming the prey of jealously with Private Sector Corporation. They are only increasing profit by increasing the cost of premium which is harmful for consumers.

4. **Insurance Schemes in the Non Governmental Organization**

The non-governmental organization include private insurance companies vis a vis mutual fund organization. These organization introducing a
lot of life and non life cover plan. These schemes privately managed by these firms under the guideline of IRDA.

But this is also truth that some problems are now too be their after privatization, such as these companies using multi-product, multi-channel and multi-segment rout by which cost of products are increasing and insurance became the only privilege of richest. The intermediaries does not fulfilling their duties because they does not possess professionalism which is a heavy barrier in the consumers profit. There are so many other lacunas in the regulatory mechanism of private companies.

2. Need to Reform Existing Insurance System

The experience after independence in insurance sector showed that the ultimate objective remained largely unfulfilled, due to the relatively low spread of insurance in the country. For efficient and quality functioning of the public sector insurance companies and the untapped potential for mobilizing long term financial resources as well as the growth of infrastructure, the government was introduce the reform process which was necessary.

There was some hardship in the insurance industry which became the reasons of reform process in insurance sector in India which is as follows:

1. Insurance companies create products and go out to find customers. They do not create products that the market wants.

2. Insurance awareness among the general public is low.

3. Term-insurance plans are not promoted.

4. Unit-linked assurances are not available.

5. Insurance covers are expensive. Inefficient management and low investment yield are responsible for the high premium charged by Indian
insurance companies investment restrictions have been responsible for low yields.

6. Returns from insurance products are low.

7. There is a dearth of innovative and buyer-friendly insurance products.

8. Most agents and development officers are interested only in producing new business servicing existing customers satisfactorily has not been a priority for them the obvious reason to this that incentives are them the obvious reason to this is that incentives are based on new business generation and not on satisfactory serving of existing customers, it is surprise to note that more than 10% of LIC policies are surrendered or get lapsed every year.

9. There is no market research worth the name and computerization is woefully inadequate.4

3. **Efforts Taking to Reform Insurance System**

The announcement of the new industrial policy of 1991, envisages transition of the economy from a regulated to liberalized and deregulated regime leading to the privatization of insurance sector to provide a better coverage to citizens and to augment the flow of long-term financial resources. This transition also meant that competition was bound to intensify in future with the entry of several private players in the field, particularly the foreign companies, in Joint venture with the Indian partners. In order to prevent misuse of the fund by insurers of policy holders and shareholders, and to ensure accountability, it was imperative to have in place an effective regulatory regime. Insurers being repositories of public trust, efficient regulation of their business became necessary to ensure that they remained worthy custodians of this trust. Further insurance cash flows generated funds which are required for investment in the social sector and for the development of the infrastructure.
Therefore, the regulation of insurance required a paradigm shift from just a supervisory and monitoring role to a developmental role so that the insurance business promoted economic growth.  

The government in a bid to complete the reforms initiated in the financial sectors established a committee headed by former finance secretary and governor Reserve Bank of India Governor, Mr. R.N. Malhotra to evaluate the insurance industry and to recommend its future direction.

R. N. Malhotra Committee Recommendations

This committee suggested the following changes for the Indian insurance system-

1. The government stake in insurance companies be brought down to 50%
2. The takeover of the holding of GIC and its subsidiaries in order to facilitate their functioning as independent corporations.
3. Allowing private enterprises in the sector with companies with a paid up capital of minimum of Rs. 100 crore.
4. No single entity to function in both life and general insurance segments.
5. Foreign companies to be allowed only in combination with an individual partner.
6. Changed to be made in the Insurance Act.
7. An independent insurance regulatory authority to be set-up
8. Reduction in the mandatory investments of LIC fund in government securities to be brought down from 75% to 50%
9. GIC and its subsidiaries are not to hold more than 5% in any company.
10. Popularization of pension schemes in rural areas.
11. Allowing PLI (Postal Life Insurance) in rural areas.
12. Rapid computerization of branches.
13. Payment of interest on delayed claims.
14. Use of revised mortality table by LIC and revision of the premium after every 10 years.
15. Issue of long term unit linked insurance plans.
16. Transfer of appropriate scheme to concerned government authorities.  

Immediately after the publication of “Malhotra Committee” report, a new committee “Mukherji Committee” was set up to make concrete plans for the requirement of newly formed insurance companies.

**Mukherji Committee Recommendations**

The recommendations of “Mukherji Committee” were never made public. But, from information that filtered out it became clear that the committee recommended inclusion of certain ratios in the insurance company’s balance sheets to ensure transparency in accounting. But the finance minister objected. He argued, (probably on the advise of some of the potential entrants) that it could affect the prospects of the developing insurance companies.

After that the insurance sector began to reform process with the passage of IRDA (Insurance Regulatory and Development Authority) Bill in Parliament in December 1999. However with the setting up of IRDA, the government has once again de-regulated the sector opening it for the private players. The entry of private players has enabled the industry to look at alternative distribution channels. To get maximum pie of the premium, every insurance company is adopting new distribution and marketing strategies. The last two year witnessing some fundamental change in insurance industry.

After the year 1999, every moment has been considered that there is a need of a consolidated law on insurance in the name of IRDA Act 1999, in
which IRDA deals with each and every issue such as the insurance of
detoxification and their related matter. 

After too be the problems was still consisting. So in the year 2003 IRDA
requested from the Law Commission of India to analysis the Insurance Act
1938 as well as Insurance Regulatory and Development Authority Act 1999.
On the request of the IRDA the Law Commission of India submit its 190 report
in the year 2004 and for the amendment of Insurance Act 1938 and IRDA Act
1999. In the year 2005 the government constituted 11 member panel under
IRDA/ headed by K. P. Narasimha (ex-chairmen of LIC) to examine the
recommendations of Law Commission. K. P. Narasimha Panel confirms to the
recommendations of Law Commission of India and gives their report in the
year 2007.

**One Ninety Law Commission / K. P. Narasimha Panel Recommendations**

The recommendations of these two groups are same which are as
follows-

1. That to participate in the global competition increases the foreign equity
   from 26% to 49% and maintains the foreign direct investment at 26%.
   Permit foreign re-insurers to open branches only for reinsurance
   business. Facilitate the entry of Lloyds of London as joint venture.

2. That to strength the privatization, the role of agent must be increase in
   the insurance business, by including them in the definition of
   “intermediaries” and by giving the responsibility to the IRDA for their
   appointment as per proper terms and conditions.

3. That to formulate firm insurance business, remove the restriction of 26%
   on disinvestment from Indian promoters, make insurance policies
   unchangeable, delete the provisions of Tariff Advisory Committee in
view of detariffication of rates and premiums, amend the provisions of Insurance Act 1938 and IRDA Act 1999.

4. That to formulate strong regulatory mechanism, make Life Insurance / General Insurance Council self regulating bodies, set up Grievance Redressal Authority, impose penalty up to 25 crore in case not compliance with the obligations for rural and social sector or third party insurance. On the recommendations of these two groups the government of India passes the Insurance Laws (Amendment) Bill 2008 and gives the strength to the Indian insurance business in terms of privatization.

4. Present Scenario of Indian Insurance System

The global integration of financial markets resulted from deregulating measures, technological information explosion and financial innovations, liberalization and globalization, have allowed with the entry of foreign and private player in the insurance business, people have got a lot of options to choose from. Radical changes are taking place in customers profile due to changing life style and social perception, resulting in erosion of brand loyalty. To survive, the forms of the modern insurance shifted to a customer-centric relation in the following terms-

1. Liberalization with Privatization

Indian economic development made to the insurance a most lucrative insurance market in the world. Before the year 1999, there was monopoly state run by LIC transacting life business and GIC transacting the rest. In the wake of reform process and passing IRDA Act 1999, Indian insurance was open for private players.

Liberalization allow to the foreign companies to enter into insurance market with Indian partners. Most of the foreign insurers joint hand with local
market. India provides immense possibilities to foreign players, because it is world most populous country having a billion of people.

At present there are 14 foreign companies those are doing work with Indian companies. The fund generated by the state owned insurers have been diversified with other new insurers; we should wait and see now the new players are going to boost up our economy.

2. **Competition**

The private and foreign entrants in insurance industry made difficult for other to retain their market. Higher customer aspirations lead to new expectations and compel them to move towards the insurers who provide him best service in time. It became less viable for them even to maintain the functional net work or competitive standards and services. To survive in the industry they analyze, the emerging requirements of the policy holders insured and they are in the forefront in providing essential service and introducing more products. Thereby they became niche specialists, who provide the right service to the right person in right time.

3. **Information Technology**

The insurer are the earlier adopters of technology, because of the information revolution, customers are free to choice from a wide range of new and innovative products. The insurance companies are utilizing the information technology applications for better customer services; cost reduction, new product design and development many more.

New technology gives policyholder/insured better, wide and faster access to product and services. The impact of information technology in insurance business is being felt at an accelerating pace. In the initial years IT was used more to execute back office function like maintenance of accounts,
reconciling broker accounts, client processing etc. with the advent of “database concept”. These functions are better integrated in an administrative efficiency.

The real revolution however emerged out of internet boom. The internet has provided new branch distribution channel to insurers. The technology has enabled the insurer to provide new products, better customer service and deeper and wider insurance coverage to them. At present insurance companies are giving customers a distinct claims ID to track claims on-line, entering on-line enrollment, eligibility review, financial reposting, billing and electronic funds transfer to its benefit clan customers.

4. **Product Innovation**

The insurers are continuously innovating new product based on forward looking models. They have developed new products, addressing the new challenges in society and the hazards from new environmental issues. Companies will need to constantly innovate in term of product development to meet ever changing consumer needs. Under standing of the customer will, enable insurance companies to design appropriate product, determine price correctly, and to increase profitability. Since a single policy can not meet all insurance objectives, one should have portfolio of policies covering all the needs.

Product development make possible by integrating actuarial, rating, claims and Indus ration system. In this present scenario, insurance companies enriching their share. Moreover, with increased commoditization of insurance products, brand building is going to play a vital role.

5. **Distribution Network**

While the companies are successful in product innovation, most of them are still grappling with multi distribution channels for capturing maximum
market share to build brand equity, and effective customer relationship as well as cost effective customer service.

While the traditional channel of tied-up advisors or agents would be the chief distribution channel, insurer should innovate and find new method of delivering the product to customers. Corporate agency, brokerage, e-insurance co-operative societies are channel which can be tapped by insurer to reach the appropriate market segment. Now days the urban masses are tapped with the new techniques provided by information technology through internet. Rural masses are attached by the consultative approach adopted by insurers. Moreover they attract the customer through telephone and mobile also.

6. Costumer Education and Services

Insurance is a unique service industry. The key industry drivers are related to life style issues in terms of perceiving insurance as a saving instrument rather than for risk cover, need based sealing, quality of service and customers awareness.

In the present competitive scenario, a key differentiator is the professional customer service in terms of quality of adviser on product choice along with policy servicing. Service focus is on enhancing the customer experience. This call the effective CRM system, which eventually creates sustainable competitive advantage and enables to build long lasting relationship.  

3. Pension: Reformation toward the Privatization and Globalization

The reformation in the Indian pension sector define under the following heads-

1. Existing Indian Pension System and its Difficulties

India does not have a comprehensive old age income security system. There are however, some mandatory scheme for employee of state and central
government, public sector bank, employee in firms and some others. In recent
years, the insurance and the mutual fund industry in India also started offering
pension plan. In 2004, a new defined contribution individual account pension
system was constituted for central government employees recruited after
January 1st 2004. Now this is open for all employee.¹¹

The existing Indian pension system arrangements divide into few
categories which are as follows-

1. Pension Schemes in the Formal Sector

Formal sector pension scheme in India divided under few categories
which are as follows-

1.1. Pension Schemes in the Statutory Framework

The scheme under statutory framework divided in some categories
which are as follows-

1. Provident Fund with Retirement Benefit Schemes

Employee’s Provident Fund Scheme

The employee provident fund programmed, established in 1952, is a
contributory provident fund providing benefits upon retirement, resignation or
death, based on the accumulated contributions plus interest, from employers
and the employees. Subscribers to the EPF have the option to make partial
withdrawals for specified purposes such as house construction, higher
education for children, marriage, and medical expenses associated with illness.
Establishments covered by the EPF can either have the EPO management in
respect of the provident fund, or can undertake process to quality as an exempt
establishment, whereby they manage the provident fund themselves.¹²
But while the EPF is an individual account DC system, the existing rule governing EPF do not cater to steady accumulation of pension wealth over long time spans. If the observed average accumulated EPF balance at retirement were used to buy an annuity, it yields a pension which is 9% of per capita GDP.

It is difficult to reconcile this failure of EPF with high level of the contribution rate in EPF. Just one year of contribution of Rs 2,500 at age 20 can yield pension wealth of roughly Rs. 25,000 at age 60, in a properly designed pension system. The failure of EPF to build up meaningful pension wealth may be related to administrative difficulties where accounts get closed or lost across job changes.\textsuperscript{13}

**Employee Pension Scheme**

The Employee pension scheme established in 1995 provides for the payment of member’s pension upon the member’s superannuation/ retirement, disability, and widow/widower pension, and children’s pension upon member’s death. The EPS program has replaced the erstwhile family pension scheme. Employers that are not mandated to be covered may voluntarily apply for coverage. The new scheme, known, as the Employee Pensions Scheme is essentially a defined benefit program provide earning related pension on superannuation, disability or death. Thus, EPF members are now eligible for two benefit streams on superannuation a lump sum EPF accumulation upon retirement and a monthly pension from the EPS.

The amount of the pension benefit is based on the employee’s average salary during the final year of employment and the total number of years of employment. Under the EPS, members must have completed the minimum prescribed years of service and the prescribed years of retirement age. Exemption from the EPS is allowed, but in this event, the employer will have to cover the government contribution.\textsuperscript{14}
But in the case of EPS concern has been express about the funding status. Under the EPF the interest rate fell dramatically, from about 10 years and some modest improvements in mortality take place in this period. However there is no change in either the contribution rate or benefit for EPF while the mandates that an actuarial report should be produced every year, it appears that one report per year has not been produced, and several recent reports have not been released into the public domain.\textsuperscript{15}

**Employee Deposit Linked Insurance Scheme**

The EDLI scheme was established in 1976. This program provide lump sum benefits upon the death of the member equal to the average balance in member’s EPF account for the 12 months preceding death, up to Rs. 25,000 plus 25 percent of the amount in excess of Rs. 25,000 up to a maximum of Rs. 60,000. Contributions received are kept in Public Account and earn an interest of 8.5% .\textsuperscript{16}

2. **Group Pension Scheme**

These Schemes comprises saving and group annuity scheme of life insurance companies. Under these schemes the interest rate has been decide as per the market rate, which distort the allocation of savings. In particular, saving intermediated through mutual funds and market based instruments in financial and capital markets are adversely impacted.

1. 2. **Pension Schemes in the Government Regulations**

These schemes are also divided under some categories which are as follows-

1. **Schemes Introduce by the Central Government Regulations**

The structure of retirement schemes for the civil servants at the central government levels are broadly similar, consisting of three types of retirement
benefits. Civil servant receive non contributory, unfunded, defined benefit pension which is indexed for price and has fairly generous commutation provisions and survivor benefits. In addition, each employee is mandated to contribute a percentage of his salary to a government provident fund scheme. Finally civil servants also receive lump sum gratuity benefit based on period of service and the salary level.\textsuperscript{17}

In the case of civil service pension schemes, the central problem has been of fiscal stress. The pension payout of the centre government rose at a compound average annual growth rate of 18\% over a few decades. These schemes were designed in world where most workers who retired at 60 were likely to be dead by 70. The value of the annuity embedded in these schemes has gone up dramatically owing to the elongation of mortality in recent decades.

The information systems surrounding these schemes are extremely weak. No information is available about autonomous bodies, grant-in aid institutions, and local government. The demographic structure of workers or pensioners is not known, which inhibits computation of India's implied pension debt.\textsuperscript{18}

So, due to the reasons of complexities of civil services pension schemes, government took some bold steps.

From January 2004, new entrants of the central government have been placed under New Pension Scheme which is a portable defined contribution scheme. Under NPS no pre retirement withdrawal are permitted. At age of 60, the accumulated balances are divided between mandatory annuities which the remaining can be withdrawn as lump sum.

2. Schemes Introduce by the State Government Regulation

In principle, each state has the freedom to design pension plan for its civil servants. In practice, states usually adopt the pension schemes followed by
the centre with relatively minor modifications. As the result states with different fiscal capabilities end up having similar pension schemes; this practice has severally affects the ability of poorer state to meet their wage and pension liabilities, and still leave aside resources for meeting social and infrastructural needs.

2. Pension Schemes in the Informal Sector

The life time poor are provided assistance through the social assistance schemes, both at the central and state levels. The schemes are usually means-tested and targeted at the destitute and poor and the infirm population over the age of 60 years. The pensions under these schemes are expected to provide between Rs. 55 – 300 Rs. per month, but their coverage is limited to between 10 and 15% of the elderly population. In addition, these schemes are usually under, poorly targeted and suffer from significant leakages. At present, majority of the workers in the informal sector are protected only through the efforts of welfare bodies, the community, or NGO’s.

3. Pension Schemes in the Governmental Organization

The governmental organization include public sector enterprises such as public sector insurance companies and banks and central bank called Reserve Bank of India, electricity board, state oil companies etc have their own pension schemes, which are managed by the concerned enterprise with little regulatory oversight or supervision. The schemes are usually contributory in nature, but details about schemes design and their actuarial sustainability are not publicly available. Therefore the professionalism with which these schemes are designed and administered is also not known.

4. Pension Schemes in the Non Governmental Organization

These refer to the employer sponsored schemes that are not statutory, not regulated by the government but these schemes provide post retirement
income to the employee on the regular basis. These schemes governed by the private manager as well as by the life insurance corporation as per the rules of income tax. These schemes are defined contribution in nature. Under these scheme liabilities define by trust fund authorities.¹⁹

2. The Need to Reform Existing Pension System

The pension reform is subject of active debate in India, today for several reasons.

First and foremost, the coverage of the current complex of pension programs is extremely narrow. Roughly 11 percent of the current working-age population participates in mandatory, formal programs designed to provide income security during old age. Moreover, these participants, salaried employees in the formal private sector and government are among the highest income workers in India. Almost 85% of workers operate in the relatively informal sector of the economy and have very little ability or opportunity to save for old age.

Second, the retirement schemes for workers in the formal private sector are complex and have performed inadequately. Two funded programs – the Defined Contribution Employee’s Provident Fund and Defined Benefit Employee’s Pension Scheme, invest contributions to retirement fund and insure against a variety of income disruption risks. The investment options are highly regulated and have yielded low returns. Moreover, premature withdrawals are freely available. Consequently, despite a very high contribution rate, funds remaining to provide income support in old age are often inadequate. It is highly likely that the Employee Pension Scheme has a fundamental imbalance between contributions and benefits, especially given its restrictive investment regulations.

Third, civil servants are covered under non-contributory, pay-as-you-go pension system; (CSPS) Civil Servant Pension Scheme administered by both
the central and state government and a separate government wide provident fund (GPF) has been constituted. The CSPS has a high dependency rate – the ratio of beneficiaries’ workers – partly because of special provisions for the military. Absence of reform in this plan is likely to place increasing pressure on the budget in the years ahead. Contributions to the GPF are deposited in the government of India public account. These funds are not segregated and invested, so the fund operates essentially on a pay-as-you-go-basis providing a source of financing for the government. Reform is important not only to achieve social objectives, but also to reduce the government’s contingent liabilities. Three aspect of current system create fiscal risk (1) the CSPS will became an increasing burden on budget; (2) the EPS is employee pension scheme likely under funded, and the budget has ultimate responsibility for benefits, and (3) retirement saving receive preferential treatment under the tax system, allowing higher income workers to reduce their tax liabilities. Reform will have limited effect in the short term but is critical to protect government finances is the medium to long term.20

3. Efforts Taking to Reform Pension System

In response to growing concern about the current system of provident and pension funds, and its likely adverse impact on poverty amongst the elderly, a number of groups have been evaluating how the current system should be changed. In 1994, the World Bank has completed work on project; “Averting Old Age Crises” in which World Bank analysis to old-age income security and suggested a set of reform options for consideration. On a parallel track, the ministry of finance has convened a committee to evaluate reform options for civil service retirement plans. Each of these efforts builds on the seminal work of the old age social and income security project. In 1999, the Ministry of Social Justice and Empowerment asked an eight member expert committee that constitutes project OASIS to examine the current vehicles for retirement saving and recommended changes to encourage saving by a broader cross section of employees.
Old Age Social and Income Security Committee Recommendations

The committee report (OASIS 2000) deals many of the problems with the current system, including the need to isolate retirement saving policy from politics, better target tax incentive, and reach out to the informal sector. To achieve these goals, the committee recommended that the existing scheme be augmented by a system of individual retirement accounts (IRAs) with the following features-

1. IRAs would not be linked to employers, but rather to workers, and each worker would be given a unique account number that would not change with payment.

2. To ensure accessibility to a broad cross section of the labour force, the minimum contribution would be initially set at Rs. 500 per year, with flexible conditions for payment, in order to encourage participation by workers who do not have a steady income.

3. To minimize transaction costs (1) a system of "point of presence" would be established to collect contributions and distribute benefits, by the post office bank etc. and (2) a depository would be created to poor individual contributions into large blocks of funds, which would them be passed on to fund managers. The depository would also be the main record keeper.

4. To give workers a choice regarding the investment of their funds, and to substantially increase return from their historical levels, a system of six competing private pension fund managers (PFMs) would be established. Each PFMs would offer three investment portfolios, distinguished by level of risk and return, from which workers could freely choose.

5. At retirement at age 60, workers would be required to use at least a portion of their balances to purchase annuities from insurance companies. The report suggest that with the recent liberalization of
the insurance sector a competitive market of annuities could emerge in the near to medium term.

6. To narrow the focus of plan on retirement, the proposed system bans early withdrawals, except where accounts balance exceed Rs. 200,000. Even in these cases, the withdrawals would be subject to a 10 percent tax to discourage such behavior. The plan would allow workers to take out loans of up to Rs. 5,000 against outstanding balance that exceed Rs. 10,000. However, in such cases subsequent contributions would first be applied towards loan repayment, so that in subsequent years minimum contributions would equal the sum of loan repayment and Rs. 500.

7. To ensure the smooth functioning of the system, prevent abuse and fraud, and safeguard workers’ investments, an independent regulator would be set up to license PFMs, oversee the entire system, disseminate information about the performance of the PFMs and make improvement to the system where necessary.

8. To encourage individuals to purchase annuities upon retirement, all lump sum withdrawals would be taxable, while income from annuities should be tax exempt.

9. A National Senior Citizen Fund would be established to encourage, catalyze and complement private sector efforts to improve the quality of life of the elderly. The present government contribution to the GPs would be redirected to this fund for three years to provide initial capital, and then discontinued. In addition, 25 per cent of all premature and lump sum withdrawal taxes will be deposited in the fund.

10. With respect to existing provident and pension funds, the OASIS report makes the following recommendation-

1. The EPF should be restructured along the lines of the IRA program, with premature withdrawals curtailed, workers given the option to
switch to the IRA plan and exempt fund switching over to same investment strategy used for the IRAs.

2. Government contributions to the EPS should be discontinued and the EPS should (1) implement a uniform 10 percent (employer) contribution, (2) adopt the IRA investment guidelines, (3) perform an annual actuarial review and adjust parameters to assure the system in self-financing, and (4) more away from lump sum distributions toward annuities.

3. Because the Ministry of Finance has already appointed a committee to review the CSPS, the OASIS committee recommended only, that the system be made contributory and put on a self-financing basis.

4. The PPF (Public Product Fund) should phase out its current system and channel all new contributions into a new fund (PPF-2) that does not rely on small saving instruments, segregates its funds from the public account, and manages them professionally in an open and transparent fashion.

5. NOAPS should be continued because, despite its limitations, it still plays an important role.

6. The government is seriously considering reforms along the lives recommended by project OASIS.²¹

While the debate amongst various stakeholders was going on the OASIS Report submitted in January 2,000, the Minister of Finance in Budget speech in Feb 2001 announced the appointment of two committees was constituted; one was IRDA and second was Bhattacharya Committee to make suggestions for the government employees and the non government’s employees.

Insurance Regulatory and Development Authority Committee Recommendations

This committee recommended regarding the reforms in the Indian pension sector in the following terms-
1. Establish a system based on privately managed, individual funded defined-contribution accounts. Lump sum payment and annuity on retirement would be actuarially determined based on fund available.

2. Private assets management functions of EPFO and exempt funds and allow private insurance firms to provide annuities. Increase coverage by covering more firms and by eliminating the present salary ceiling of Rs.6500. Phase out government subsidy of 1.16%.

3. For person not covered by any scheme, allow a limited number of private assets manage to operate, each offering three management portfolio options. Participation would have choice among fund managers selected through competitive binding process regulatory authorities.

4. Employers and fund managers responsibilities to participants would be that of ‘principal’ and ‘agents’ and fiduciary in nature. Fund managers would work for a fee with no performance guarantee. However, it is hoped that with expert management skill and wider investment choice, participants would be better off than presently available through publicly managed fund.22

Bhattacharya Committee Recommendations

The recommendations of this committee are as follows-

1. A funded defined benefit, pay-as-you-go scheme, or a pure defined contribution scheme is not suitable for government employees; instead a hybrid defined benefit/defined contribution scheme is recommended. This is a two tier scheme. In the first tier, there is a mandatory contribution of 10% each by employers and by employees. The accumulated funds would be used to pay pension in annuity form. The second tier is to promote personal savings and there is no limit for employee’s contribution but employer’s contribution would be matching
and limited to 5%. Accumulated funds can be withdrawn in lump sum on converted into annuity at the time of retirement. These payments would be tax exempt and portable if an employee changes job before retirement.

2. Funds collected in the first tier would be deposited in a separate fund and would be invested in both debt and equity. Some funds earmarked for active fund management including for short term trading for better return. However, irrespective of fund performance, government would remain liable for pension to its employees based on predetermined benefit formula.

3. Contribution obtain in second tier will have a separate institutional structure and employees would have a choice of funds to investment. Employee may decide to continue, quit, or swap among funds while in service. Government will not guarantee any specific rate of return.

4. The new scheme would be applicable to new employee only.

On the recommendations of these committees the government of India introduces the Pension Fund Regulatory and Development Authority Ordinance in the parliament in the year 2004 which was cleared by the government. Again in the year 2005 the Pension Fund Regulatory and Development Authority Bill was passed by the government than referred to the Parliamentary Standing Committee for report which objected it on some points. So it is still in pending. But the government implement the New Pension System defines under the PFRDA Bill on the employees recruited at or after first January 2004.

4. Present Scenario of Indian Pension System

In India there has been a considerable debate and experience with pension reform, but no single idea, system or model has emerged. There has however been appreciated that from a practical policy point of view, a multi-
tier framework is better able to address various pension-able risk than reliance on a single tier.\textsuperscript{24}

Reformed Model of Pension

After a broad discussion, three pillar systems recommended to provide for old age financial security. The three pillar are-

1. **A mandatory, publicly managed, tax financed pillar for social insurance – (Defined Benefit Plan)**

   This pillar resembles public pension plans, providing a social security net for the old and poor, particularly for those whose lifetime income was low or who can not afford to pay for building a reasonable retirement income. These are based on the principles of social insurance and are wholly financed by the state either out of general tax revenue or by some kind of special tax or cess.

2. **A mandatory, privately managed, fully funded pillar for old age saving- (Defined Contribution Plan)**

   The second pillar requires that the people save mandatory for old age and benefits are actually linked to contributions. It should preferably be privately managed fully funded, and managed competitively.

3. **A voluntary, privately managed pillar for those who wants more protection in their old age**

   The third pillar, voluntary savings and annuities, is meant to provide supplemental retirement income for people who want more generous old age pensions.\textsuperscript{25}

   India does not have the first pillar as suggested because the government does not have enough resources to provide a social security safety net for aging
population, so funds have to come from working population who plan their own retirement and thus, the second pillar is the core programmed for the population. Recently India adopt a new system based on second pillar which known the “New Pension System.”

New Pension System

In India, in the field of pension, there is a strong distinction between the issue of “accumulation phase”, where a worker is accreting monthly saving through contribution into a pension account, and the “benefit phase”, where the worker is retired and drawing down those savings. While the age retirement in India is presently 60, it is likely to shift to 65 years in coming decades. due to improvement in mortality. In this case, from age 20 till 65, for a period of 45 years, the pension business consist of building up pension wealth using the service of fund managers. From age 65 till 85, for a period of 20 years, the pension business consist of producing pensions using the stock of wealth available at age 65. So to regulate this process recently the government of India introduces the NPS.

Key Element of New Pension System

The key elements of New Pension System augmented are as fallows-

1. An individual account, defined contribution system,

2. Separation between the pensions sector (i.e. accumulation) and benefit which are purchased from annuity provider,

3. A separate pension regulator,

4. Probability of pension accounts across job changes and portability of pension assets across the multiple fund managers, and investment product,
5. A menu of investment choice through which assets volatility can be controlled by the individual, where equity investment is available as investment choice,

6. Reduced pension assets portfolio volatility, using international diversification,

7. A simple framework through which individuals face a choice between multiple fund managers and multiple assets classes,

8. Central record keeping infrastructure,

9. A focus on IT which will yield low transactions costs despite small value contribution and small value accounts balance,

10. Rules that deter premature withdrawals but do not completely prohibit it

11. Rules that encourage annuitisation but not mandate it,

12. Tax treatment using an EET system.

**Unbundled Architecture of New Pension System**

Under the NPS the over all pension problem is broken up into four distinct components: front-end-service, record keeping, fund management and annuity production of unbundled architecture. The importance of these components is as follows-

1. **For-End-Services**

The for-end-services are envisaged to be provided by the large existing network of bank branches, post offices etc, which would provide an off-the-shelf network of offices. The reuse of existing infrastructure cuts the costs. In addition, the sharing of these "point of presence" by multiple different pension
fund managers eliminates the costs associated with a separate set of front-end-officers in the country for each PFM.

2. Recordkeeping

Under the NPS, recordkeeping services envisaged to be centralized in a “Central Record Keeping Agency”. This agency would produce new public goods for the pension sector. There would be a considerable role for the state in the contracting that will lead to the CRA. The CRA would know complete facts about every pension system participant; it would be able to give out comprehensive account balance account statements; it would be the single point at which instructions for switching from one pension fund manager to another would be supplied. The CRA will induce netting efficiencies by aggregating up instructions and contributions across all participants per day and only executing the net transaction required with respect to fund managers. The CRA has strong increasing returns to scale. The use of such a central facility reduces the costs.

3. Fund Management

In case of NPS, the professional fund managers would perform fund management services. It is envisaged through roughly six pension fund managers would be required, each of whom would offer three standardized schemes. The use of these schemes would facilitate direct comparison of performance. The six managers would be selected through an auction process, which would focus on fees and expenses. The firm who bid the lowest sum of fees and expenses would get a contract to manage assets for system. The auction process is expected to result in drastically lower fees and expenses as compared with ordinary market process that have been in the mutual fund industry or insurance industry. Through this system, the participant would accumulate pension wealth. In the working year, a regular stream of contributions would go into the pension account. The participants would
choose between multiple competition fund managers, each of which would offer a comparable set of standardized three products. These products would induce commoditization, and lower fees and expenses. The investment return on these schemes would swell the pension wealth.

4. Annuity Production

When a participant reaches and seeks to obtain a monthly pension, he would be able to use some or all of the accumulated pension wealth in order to buy an annuity from the existing life insurance companies. The annuity is a product which converts a stock of wealth into a flow of monthly payments until death. This function is envisaged to be performed by existing life insurance companies.26

Comparative Analysis of New Pension System

The comparative analysis of NPS is define under the following heads-

1. Risk under different Plan (Defined Benefit v/s Defined Contribution)

Under defined contribution plans, variations in assets yields and assets prices or unexpected changes in longevity affect the pension that will be paid. Under defined benefit plan, pension-relevant surprises change how much the defined benefit will cost. In the first scheme, the pensioners takes the risk, while in the second, the provider of pension will take risk. Risk is inescapable.

The choice between defined contribution and defined benefit plan depends on more than economic outcome. Individual values play a role as well, since choice involves a tension between the principle of individual responsibility and the competing principle of collective responsibility that involves sharing of costs and risks. Choice would depend upon to which group the individual belongs. Financially successful people believe in individual ownership and choice. They have many other resources to fall back upon, but
low wage earners want assured returns, which would guaranteed their well being. Unfortunately, most Indians are in the latter category.

2. **Management of Fund under different Plan (Publicly Managed v/s Privately Manage Fund)**

   Under defined contribution plan the fund are privately managed. The private fund management industry in India typically charge 2 per cent as annual assets management fee, in addition to the brokers or commissioned sales staff charge, marketing or selling fee and then there are entry and exit load. Further, management often trades too much and generates soft commission and trading fees. Under defined benefit plan the employer or group of employer choose the investment manager and bear the risk.

   So even if the return under privately managed funds is slightly higher, the reason for return differential has nothing to do with privatization. It has more to do with the restrictions governing investment of fund.

3. **Investment Policy under different Plans (Investment Policy/Fortfolio Diversification)**

   Under defined contribution, the choice should be given to the employee in selecting investment fund, timing and form of withdrawals. It should be either voluntary or mandatory. The defined contribution plan suggests deployment of fund in the equity markets where return is significantly higher. The proposed pension system would offer three kinds of funds: safe income, balance income and good growth. The investment in this fund invests in the index funds. Later on actively managed fund offer to the pensioner. No doubt it is good option but some problems are still attach their. Employee does not have knowledge of investment to make sound choice and some may not wish to do so. In particular, they are concerned about the risk from poor investment choices and from the accident of retiring when the market value of assets is low or the cost of annuities is high. There will be call for the government to ensure
some returns for mandated charged for guarantee, are preferable to bailouts. This problem solved by the government guarantee principle suggested by defined contribution plan. If return are disappointing and the retirement account deliver less than the guaranteed level, the government will pay up, 8 percent of the contribution. Under defined benefit plan, publicly managed fund invest in the diversified portfolio that includes stocks and indexed funds or showed they continue to be invested only in treasury and approved bond.

So, when ultimate liability bear by the government under defined contribution plan which create the distort behavior of saver and provider, why the defined benefit is not better where fund totally manage and liability bear by the government.

4. Government Liabilities under different Plan (Pay-as-you go v/s Separate Fund Creation)

Under defined contribution plan the government create a separate fund in which employee vis a vis government made the contribution. The government contribution will be 5% of wages. This fund manages by the private fund mangers. When, the government pays the pension borrowed from the market that means from these fund managers. Under defined benefit system the government does not create a separate fund but on his own wisdom decide "pay-as-you go" system.

So, the problem with defined contribution system is that the private agencies do not seem to be cost effective and the government does not exercise enough discipline in managing its own wage costs and associated pension cost.

After the overall discussion the conclusion is that the first pillar is most effective, but in India the first pillar is almost non-existent. The government does have some poverty alleviation programmed but they are too insignificant compared to the country's needs and their implementation is mostly political in nature. In case of need, old people generally rely on immediate family
members and private charities. With the breaking of the joint family system, it has become inevitable that people plan for old age financial security while they are young and working.

The second pillar is found mostly in the organized sector and is in the form of employment liked schemes. Against a working class population of 400 million only 35 million have access to a pension system of these 35 million, 11 million are in civil service and 24 million are members of various employee’s provident fund and pension’s schemes.

4. Concluding Remark

From the foregoing analysis, it can be conclude that the privatizations is a mechanism whereby the activities of enterprises that once performed by the government and its employees now managing by the private business entities and individuals, often with much better results in terms of costs, product innovation, quality of services etc. The privatization achieving these results by replacing the government monopolies with the competitive pressure of market places to encourage efficiency, quality and innovation in the delivery of goods and services.

The decision of the government for privatization of insurance sector has achieving a good progresses but the process of privatization in pension sector is now in pre mature stage because there is no better mechanism for the proper regulation of pension sector by the hand of private regulator.

So there is need of much consensus about the proper regulation of pension sector and better regulation of insurance sector.
Notes and References


2. Ibid, page no. 226.


8. The Hindu, 4th, November 2006.

9. Supra note- 5.


13. Supra note- 3.

14. M. G. Asher and Deepavasudevan, Reforming India’s Social Security for Twenty First Century, Journal of IIM Bombay, page no. 10,

15. Supra note -3.


25. Supra note- 23, page no. 2.
27. Supra note - 23, page no. 5-10.