Pension Plans

Celebrating the 60th Year of Excellence

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

PENSION PLANS

Basic Draft of this Publication
was prepared by CA. N.D. Gupta

The Institute of Chartered Accountants of India
New Delhi

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FOREWORD

One of the biggest challenges facing the world in the twenty first century is to adjust our society to the greatest change the twentieth century has shaped, which is the change in demographics. These demographic changes have been driving the governments world over to initiate pension reforms. Accordingly the preceding decade has been a decade of pension reforms throughout the world. Even in developed countries the driving force has been the threat that current systems will become unaffordable in coming decades, with demographic developments presenting a major risk. In another setting, countries in the process of transition from a command to a market economy are confronted with the challenge of introducing a public pension system that will provide social security in old age but that also supports the fundamentals of a market economy. In India the pension reforms have been initiated with the formation of Pension Fund Regulatory and Development Authority.

Our Institute has always been seen as proactive to macro economic changes in the country by way of building and maintaining core competencies amongst the members of the Institute relevant to synchronise various stakeholders of our economy to such macro economic changes. It is heartening to note that the Committee on Insurance and Pension has brought out a publication on Pension Plans covering key issues relating to various pension schemes and the reforms being implemented in this sector. The Institute would take further initiatives relevant to this sector such as development of Guidance Note on the Accounting / Auditing Aspects of Pension Plans, Accounting and Auditing Standards relevant to the Sector, training the members of the Institute on the entire gamut of the pension plans with suitable coordination of the Pension Fund Regulatory and Development Authority in due course of time.

I wish to place my sincere gratitude to CA. N.D. Gupta, Past President of our Institute for preparing the basic draft of this publication. I appreciate the efforts put in by CA. Anuj Goyal, Chairman of the Committee on Insurance and Pension and CA. Rajkumar S. Adukia, member of the Committee on Insurance and Pension and the officials of the Committee on Insurance and Pension's Secretariat for publishing this book.

New Delhi
27th April 2006.

(CA. T. N. Manoharan)
President

PREFACE

Pension Policy in India has conventionally been based on financing through employer and employee contribution. As a result the coverage has been restricted to the organized sector and a majority of the workforce in the unorganized sector has been denied access to formal channels of old age financial support. The existing mandatory and voluntary private pension system is characterized by limitations like fragmented regulatory framework, lack of individual choice and portability and lack of uniform standards apart from the problem of limited coverage.

Reforms in Pension Sector in India have started on a modest scale in order to build an effective, efficient and accessible delivery mechanism. The road ahead has many challenges, which need to be tackled effectively for the system to spread wide enough to cover the unorganized sector workers who have low level of financial literacy who requires guidance, encouragement and support to save sufficiently for their old age and the capability of the State and the labour market to face the challenges is likely to become even more limited than is the case at present.

Members of our Institute has a great role to play in the New Pension System and the Committee on Insurance and Pension thought it appropriate to build appreciable level of competencies on the entire scope of the pension funds. This publication on Pension Plans is a modest beginning to educate our members on the various issues relating to existing systems of pensions and the New Pension System. I am grateful to our Past President CA.N.D.Gupta for sharing his expertise and experience on the pension plans by preparing the basic draft of this publication.

I place on record my gratitude to CA.Rajkumar S. Adukia, immediate past Chairman of the Committee on Insurance and Pension for his efforts to bring out this publication. I am also thankful to CA. T.N. Manoharan,

President of ICAI, CA. Sunil Talati, Vice-President of ICAI, CA. Charanjot Singh Nanda, Vice-Chairman of the Committee on Insurance and Pension for their involvement and encouragement and the members of the Committee on Insurance and Pension CA. Kamlesh S. Vikamsey, CA. Harish Narendra Motiwalla, CA. Jaydeep Narendra Shah, CA. S. Santhanakrishnan, Smt. Anita Kapur, CA. K. C. Parashar, CA. Pawan Kumar Sharma, CA. P.S. Prabhakar, CA. Mukul Bansal, CA. Pankaj Agarwal, CA. N. Goutham Chand, CA. Anil Kumar Sharma, CA. Naveen Kumar Soni and CA. O. P. Mutha for their valuable involvement in this regard. I appreciate the efforts put in by the officials of Secretariat of the Committee on Insurance and Pension for their contribution in publishing this book.

I am confident that the book will be found useful by the members of our Institute and others concerned.

New Delhi
27th April 2006.

(CA.Anuj Goyal)
Chairman
Committee on Insurance and Pension

1 INTRODUCTION

1. Pension

A pension is a steady Income paid to a person (usually after retirement). Retirement plans (also known as superannuation) are a product or a method of investing which invests money now to provide for a retirement pension later.

"Pension" is a payment made by an employer to his retired or ex-employee in consideration of the services rendered by him in the past during his employment with the employer or in his organization.

Webster's New international Dictionary defines pension as "a stated allowance or stipend made in consideration of past services . . ." Tomlin's Law Dictionary defines pension as "an allowance made to any one without an equivalent".

Pensions have traditionally been payments made in the form of a guaranteed annuity to a retired or disabled employee, or to a deceased employee's spouse, children, or other beneficiaries. A pension created by an employer for the benefit of an employee is commonly referred to as an occupational or employer pension.

Labour unions, the government, or other organizations may also sponsor pension provision.

Pension is described in Section 60 of the CPC and Section 11 of the Pension Act as a periodical allowance or stipend granted on account of past service, particular merits, etc. Thus monthly allowance to the younger brother of a ruler was treated as a maintenance allowance and not pension (Raj Kumar Bikram Bahadur Singh, vs. CIT 75 ITR 227(MP))

There are three important features of 'pension'. Firstly, pension is a compensation for past service. Secondly, it owes its origin to a past employer-employee or master-servant relationship. Thirdly, it is paid on the basis of an earlier relationship of an agreement of service as opposed to an agreement for service. This relationship terminates only on the death of the employee concerned.

2. Family Pension

Family pension is defined in Section 57 as a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of death. Pension and family pension are qualitatively different. The former is paid during the lifetime of the employee while the latter is paid after his death to the surviving family members.

In India, pension at least in so far as civil servants and military personnel are concerned has a strong historical continuity and foundation. The 1986 report of the Fourth Pay Commission chaired by Justice P.N. Singhal of the Supreme Court, enunciated the principles in its justification. It traced the 'custom' of providing pensions for the aged employees who were no longer able to discharge their duties efficiently to the nineteenth century in Europe that spread to other parts of the world thereafter.

'A Right'

Coming to the aspect of pensions, the same report categorically declared thus : "In so far as these employees are concerned, pension is not by way of charity or an ex-gratia payment, or purely social welfare measure, but may fairly be said to be in the nature of a 'right' which is enforceable by law." The report also drew sustenance from the judgment of the Supreme Court in the 'Deokinandan Prasad vs. State of Bihar and Others' (1971-Supp. SCR 634) which held that "pension was not a bounty payable on the sweet-will and pleasure of the Government and that on the other hand, the right to pension is a valuable right vesting in a Government servant." The court also held that the right to receive pension "is property under Article 31(1) …" and under Article 19(1) (f) and it is not saved by sub-article (5) of Article 19." Though right to property is no longer in vogue as a fundamental right the validity of the right to pension is well substantiated.

Having firmly laid the legal basis of the right to pension, the Fourth Pay Commission Report went on to trace the historical background of this right as it developed in India. The report recounted thus: "As a result of the recommendations of the First Central Pay Commission, the Liberalised Pension Rules, 1950 were notified on April 17, 1950, with option to those who had entered permanent pensionable service before October 1, 1938, to come over to those rules or continue under the earlier regulations and orders." There was continuity in that these were in the nature of "modifications

to the earlier Civil Service regulations and instructions and implementation of later pay commissions. Ultimately, a single set of rules called the Central Civil Services (Pension) Rules 1972 were issued and came into effect from June 1, 1972. The Civil Pension Commutation Rules, 1925, were replaced by the Central Civil Services (Commutation of Pension) Rules, 1981, and came into force from July 1, 1981." The option as stated above notified allowed employees hitherto covered by contributory provident fund to come over to coverage of pension. And the option continued thereafter, so much so the Pension Rules of 1972 referred to employees to whom these rules applied simultaneously listing out exclusion from pension of "persons entitled to the benefit of Contributory Provident Fund."

3. Social Benefit

It would be interesting to note that the Fourth Pay Commission did not merely deal with the legal basis of provision of pension but also dealt with the philosophical and moral basis too to buttress its recommendations. The Commission postulated: "but the concept of 'pension, however old in its origin, had the latent and real desire to provide for an eventuality—known or unknown. The known eventuality was old age and probable reduction in earning power, while the unknown eventuality was disability by disease or accident or death. Its real purpose was security, even though the beginning was oblique, undiscernible and faint. But the germ of an effort to provide security ran through the provision and it is natural that it should have grown and flowered with the development of human understanding and desire to look after and provide for those who deserved it, for man has constantly been seeking means by which to enhance his economic security… Some benevolent employers go to the extent of regarding pension as an absolutely indispensable complement of wages—as a terminal benefit. That, however, is apart from another aspect bearing on pensions—the social benefit…."

4. Constitutional Basis

The report goes on to declare: "the political philosophy to which the State has committed itself is also a relevant factor. Thus in a country like ours where the Preamble to the Constitution itself declares that the people had solemnly resolved to constitute it into a 'socialist' democracy and to secure to all its citizens 'justice, social,

economic and political', it will be quite reasonable to hope that an honest effort will be made to achieve that objective. ... The political philosophy of the State is also a relevant factor in determining what will be a proper and suitable scheme of pension."

Pensioners constitute a class under Article 14: The Commission has made one other factor clear that the pensioners constitute a class by themselves (upheld in the Punjab and another vs. Iqbal Singh and D.S. Nakara (1976 - 3 SCR 360 & D.S Nakara vs. Union of India AIR-1983 SC 130) and there could be no discrimination among them on the basis of the date of retirement (for that matter their date of appointment as well).

5. Concluding Remarks

From all this certain things are crystal clear:

1. Pension is not a gratuitous payment;

2. It is a social, moral and legal commitment;

3. It is enjoined that the State should expand the scope of its coverage and not abridge it.

4. That includes protection of the class of people who are already entitled to it, like the government employees who constitute a class by themselves. Any differentiation such as the one sought to be made as between those who were appointed on or after April 1, 2004 and others would be discriminatory on moral and ethical grounds as well.

5. For the government employees pension was in substitution of the contributory provident fund and it is not as if the government was paying pension from out of taxes.

6. The scheme of pay-as-you-go is by no means an irrational concept and is in vogue in many countries. Be that as, it may, pension for Government employees is in reality, in lieu of Government's contribution to provident fund.

7. Merely because the government did not fund its contribution along with those of its employees and constitute a pension trust (as is done in many countries including in respect of Federal Social Security in the US, its character does not change.)

8. The Government should make public what would be the value of the fund if such funding had taken place and not beguile the general public into believing that it is paid out of the revenue.

9. The central theme of providing pension is to ensure certainty of defined and adequate payment when the contingency of old age, disease, disablement or death occurs. The central idea therefore is certainty. The pension reforms as contemplated by the government and as per the change brought about arbitrarily for government employees appointed on or after April 1, 2004, militates against this principle of 'certainty' as it would be based on the future value as dictated by the stock market.

10. All along the government did not contribute to the Pension Fund as it would have done in respect of contributory provident fund. As per the new dispensation, it has to physically set apart a matching contribution to the pension fund.

2 BUYING A PENSION PLAN

The five factors you need to consider before you buy a pension plan are as follows:

1. Safety

When it comes to planning for your retirement, do not compromise on safety. Having said that, it is equally important to grow your capital over the years to give you the best inflation-beating returns. Ideally, there should be a balance between safety and returns. This will determine the kind of plan you choose.

2. Performance

It makes eminent sense to avoid putting all your eggs in one basket. More so, since none of the private insurers has a performance track record available for evaluation. Although LIC has been around for decades, it has opted out of assuring returns as it did in the past. So spread your investment over plans of more than one companybut not at the cost of your investment objective and risk profile. A moderately conservative strategy could be to opt for a pure pension (participating) plan and a balanced investment unit-linked plan from different insurers.

3. Transparency

Insurers are way behind mutual funds when it comes to disclosures-particularly on investment portfolio, services and expenses charged. The only pension plan that is ahead of the rest is ICICI Prudential's Life Time Pension, which declares its NAV bi-weekly and its portfolio quarterly. Participating plans only declare the bonus rate on an annual basis.

4. Exit Option

At the time of vesting (the chosen retirement age), policyholders should have the option to choose the best annuity in the market, and this is known as the open market option. Almost all pension plans, except LIC's New Jeevan Suraksha 1 pension plan, give the policyholder the flexibility to

buy an annuity plan from any other insurer of his choice. This gives you the freedom to buy the best annuity in the market.

5. Other Benefits

Last but not the least, a prudent factor while choosing a pension plan is that it should preferably be a pure pension plan. Frills like life insurance cover and accident or critical illness riders should preferably be avoided. Reason: while it comes at a cost, these features can anyway be taken through a separate policy, the tax benefit of which can be claimed under a different sections. By doing so, an individual also gets the freedom to choose from the best options available in the respective categories.

3 CURRENT PENSION SCHEMES IN INDIA

1. Employees' Provident Fund (EPF)

The EPF programme, 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 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 EPFO manage the provident fund, or can undertake processes to qualify as an exempt establishment, whereby they manage the provident fund themselves. In general, exempted establishments are large companies, (Private Provident Funds).

Statistics about EPF:	
Workers covered	24 million
Contribution rate	12 % employers' share and 12 % employees' share
Total contribution Diverted as under	24 per cent • Provident Fund-15.67 per cent • Pension Fund-8.33 per cent
Government contribution in pension fund	1.16 per cent

In India the EPF has been used more as medium of tax evasion by the salaried classes as the entire amount deposited in EPF is deductible for income-tax estimation purposes. This negates the purpose for which it was originally set up for, i.e. as a fund that would cover expenditure during the lifetime after retirement.

2. Employees' Pension Scheme (EPS)

The EPS, established in 1995, provides for the payment of a member's pension upon the member's superannuation/retirement, disability, and

widow/widower pension, and children's pension upon the member's death. The EPS programme has replaced the erstwhile Family Pension Scheme (FPS). Employers who are not mandated to be covered may voluntarily apply for coverage. The new scheme, known as the Employees' Pension Scheme (EPS), is essentially a defined-benefit programme providing earnings related pension on superannuation, disability or death. Thus, EPF members are now eligible for two benefit streams on superannuation a lumpsum 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 a minimum of ten years of service and must be at least 58 years old. However, if an employee has completed twenty years of service, he/she may obtain an early pension from age 50. Under this provision, the amount of pension benefit is reduced by 3 per cent for every year falling short of 58. Exemption from the EPS is allowed, but in this event, the employer will have to cover the government's contribution.

However, participation in the EPS programme was voluntary for the existing workers as on 1995 but mandatory for the new workers whose monthly pensionable earnings did not exceed Rs. 5000. Aggrieved workers alleged that the pension from the EPS was substantially inferior as compared to the public pension schemes and that the return from the scheme was even lower than the provident fund arrangement. The debate surrounding the EPS continues unabated till today, with many trade unions filing litigations against the scheme.

This new system along with the recommendations of the Fifth Pay Commission Report has only added to the liabilities of the government.

3. Employees' Deposit Linked Insurance Scheme (EDLI)

The EDLI programme was established in 1976. This programme provides lumpsum benefits upon the death of the member equal to the average balance in the member's EPF account for the 12 months preceding death, up to Rs. 25,000 plus 25 per cent of the amount in excess of Rs. 25,000 up

to a maximum of Rs. 60,000. Contributions received are kept in the Public Account and earn an interest of 8.5 per cent. Health care and insurance are covered through Employees' State Insurance Corporation.

Insured persons	8.8 million
Beneficiaries	34.2 million
Contribution rate	4.75 per cent employers' share and 1.75 per cent employees' share
Total contribution	6.5 per cent

4. Other Schemes

The central government alone administers separate pension programmes for civil employees, defence staff and workers in railways, post, and telecommunications departments. This is called the Civil Servants' Pension Scheme (CSPS). These benefit programmes are typically run on a pay-as-you-go, defined-benefit basis. The schemes are non-contributory, i.e. the workers do not contribute during their working lives. Instead, they forego the employer's contribution into their provident fund account. The entire pension expenditure is charged in the annual revenue expenditure account of the government.

Federal Government including military personnel	4 million
State Government civil services including personnel employed in state-owned public sector undertakings	6 million
Benefits available to those who are covered under the pay-as-you-go systems	50 per cent of average wage earned during the last 12 months.

In addition to the provident fund, workers in both public and private sectors receive a second tier of lumpsum retirement benefit known as gratuity. It is paid to the workers who fulfil certain eligibility conditions like a minimum

qualifying service period of five years. It is equivalent to 15 days of final earnings for each year of service completed subject to a maximum of Rs. 350,000. The cost of gratuity is entirely borne by the employer.

The Public Provident Fund (PPF) scheme, introduced about three decades ago, is meant to provide unorganised sector workers with the facility to accumulate savings for old age income security. Under the scheme, a minimum amount of Rs.500 to a maximum of Rs.70,000 per annum can be deposited into the PPF account. These investments are eligible for tax rebate under the new Section 80C of the Income Tax Act with effect from 1.4.2006 (Assessment year 2006-07) and interest at a 8 per cent p.a. is fully tax exempt under Sec 10.

As the scheme is largely urban centric,it is used more as a tax planning vehicle by high-income savers than an old age income security plan. The 8 per cent tax-free return that a PPF investor is guaranteed is equivalent to a 16.8 per cent pre-tax return for a marginal income tax payer.

In an effort to widen the reach of the social safety net for the aged poor, the central government, in 1995, introduced a more comprehensive old age poverty alleviation programme called the National Old Age Pension (NOAP) under the aegis of the National Social Assistance Programme (NSAP). The scheme aims to provide monthly pension to thirty percent of the poorest elderly. This programme provides benefits for poor people above the age of 75 years. Under the programme a pension of Rs. 75/- per month is provided to eligible persons.

The formal old age income security system in India can thus be classified into three categories:

- The upper tier consists of statutory pension schemes and provident funds for the organised sector employees.
- The middle tier is comprised of voluntary retirement saving schemes for the self-employed and unorganised sector workers.
- The lower tier consists of targeted social assistance schemes and welfare funds for the poor.

4 TYPES OF PENSION PLANS

1. Defined-Contribution Plan

Under a defined-contribution plan, workers build up either explicit or implicit retirement accounts that fund retirement.

The benefit is determined by

(1) the level and timing of contributions,

(2) the rate of return on the retirement accounts and

(3) the form in which benefits are realised, including annuitization, programmed withdrawals and lumpsum distribution.

The relationship between contributions and benefits is transparent, which may improve compliance incentives.

In a defined-benefit system, benefits are usually determined by multiplying a replacement rate by a pension base.

The replacement rate is typically an accrual factor times the years of service, and the pension base is a function of a worker's earnings history. Since this type of system often ignores the time path of contributions in calculating the replacement rate and the pension base, the tie between benefits and contributions can be quite loose.

2. Pay-as-you-go System

In a pay-as-you-go system, pension payments are made using the taxes collected from the younger taxpaying generation. Their pension payments, in turn, are made from the taxes collected subsequently.

3. Funded System

In a Funded System, pension payments are invested in a variety of financial assets. Funding provides an opportunity to capitalise from investment in financial markets, where the rate of return is likely to be higher than the implicit rate of return to contributions in a pay-as-you-go pension system. The benefits of funding can be enhanced by investment diversification.

Funded systems can reduce—though arguably not eliminate—the vulnerability of a pension system to adverse demographic trends and political pressures.

4. Participating Pension Plans

In these plans, investments are regulated by IRDA (Insurance Regulatory Development Authority) to minimise risks. A minimum of 20 per cent of the investment should be in Government of India (GOI) securities, another 20 per cent in GOI or GOI-backed securities and the remaining 60 per cent in approved bonds (mostly AAA rated) and equities (as approved by IRDA).

The norms, however, specify only the upper limits and the risk levels could be far lower. Says Pankaj Seith, head (marketing), HDFC Standard Life: "Though 40 per cent seems small, we have a larger portion of the fund invested in safe GOI securities." Besides the investment guidelines, regular monitoring by the IRDA ensures protection of investor interest.

5. Unit-linked Pension Plans

The investment model adopted by unit-linked plans, on the other hand, is like a mutual fund scheme where returns are determined by appreciation in the unit's net asset value. The investment allocation in such plans is specified by the investor. For instance, ICICI Prudential's LifeTime Pension Plan (the only unit-linked pension plan on offer today) allows you to choose from three options—income, balanced and growth. While the income fund is 100 per cent invested in debt instruments, the balanced and growth options provide flexibility to allocate up to 40 per cent and 90 per cent, respectively, in equities. This gives the policyholder an option to choose the risk—and, therefore, the return—he is comfortable with. These plans also allow you to switch between the three options for free once a year.

This class of pension plans is clearly more investor-friendly. Participative plans have an element of discretion regarding bonus declaration by the insurance company (usually lower than earned), which could be counterproductive for a policyholder. But in case of a unit-linked plan, appreciation in units is what has been earned and policyholders get exactly that; nothing more or less.

5 PENSION SCHEMES OF EPFO

The Pension schemes of Employee's provident Fund Organisation (EPFO) are as follows :

1. **Family Pension Scheme 1971 (FPS-71).**
   - If member is alive, no pension
   - If member is not alive, pension to spouse only
   - Pension amount was also very small as the contribution collected to the scheme is only 3.34% (1.67%x2) of the wages
   - This scheme ceased when the EPS-95 came into existence
2. **Employees Pension Scheme 1995 (EPS-95).**
   - If member is alive, pension to member
   - If member is not alive, pension to spouse and two children below 25 years of age
   - This scheme is applicable to all members who joined EPF after 15.11.1995

So we may think only about EPS-95 here onwards

Employees' Pension Scheme 1995 (EPS-95)

Funding of the Pension Scheme

An amount equal to 8.33% of wages is pooled into the EPS from the employer's contribution, i.e., If a PF member gets Rs. 1000/- as monthly wages and he and his employer contributes 10% each, Rs. 100 + Rs.17 (=117) goes to Provident Fund and Rs. 83 goes to Pension Fund. The government also contributes to this welfare scheme at the rate of 1.16% of wages.

Each year Pension Relief is declared on the basis of valuation of the Inflow and outflow to the EPS annually. During 2002-2003, 4% of Pension Relief was declared, (an increase of 4% in pension amount).

Four situations when pension can be applied for :

1. On superannuation • Age 58 years or More and pension • Atleast ten years of service	The member **can continue in service** while receiving this On attaining 58 Years of age, an EPF member ceases to be a member of EPS automatically
2. Before superannuation • Age between 50 and 58 years and • Atleast ten years of service	The member **should not be in service**
3. Death of the member	Death while in service or Death while not in service
4. Permanent disability	Permanently and totally unfit for the employment which the member was doing at the time of such disablement

• No pensioner can receive more than one EPF Pension.

Calculation of pension:

Those who joined AFTER 15.11.1995	Those who joined BEFORE 15.11.1995 Here, the formula of calculation of pension is:
Here, the formula of calculation of pension is similar to that of a Govt. Employee, i.e. Proportionate reduction	Past Service benifit + Pensionable service benefit -
$\frac{\text{Average Salary X Service}}{70}$	subject to minimum pension specified for each group. (X-Rs.800, Y-Rs.600, Z-Rs.500)
members are defined with Maximum service for the calculation of service is 35 yrs.	These three categories of reference to their age as on 16.11.1995 as follows: • X : those who have not

If a member has maximum service, pension will be :

$$\frac{\text{Average Salary}}{2}$$

The Average Salary is named as pensionable salary in the scheme. It is arrived by considering the average contributing salary preceeding 12 months from the date of exit

Even though you may be drawing Rs. 20,000/- as salary per month, your company need to contribute only Rs. 541/- towards pension fund.

attained 48 years

- Y : those who have attained 48 years but less than 53 years; and
- Z : those who have attained 53 years or more.

Past service benefit : Portion of pension amount because of your service before 15.11.1995 (For the calculation of this you have to refer to tables A&B) **Pensionable Service Benefit :** Portion of pension amount because of your service after 15.11.1995(same as the calculation of pension who joined after 15.11.1995) **Proportionate reduction :** if the past service is less than 24 years and past service benifit + Pensionable service pension is less than Rs.500/-

- If no wage is earned for a certain period, that period is to be deducted from the service (as there will be no contribu-tion to Pension Fund)

Pension Capitalising Options

1. Commutation

You can opt for commutation of pension and percentage of commutation. Maximum % of commutation is 33.33%. In this case, the pension will be reduced by 33.33% and you get 100 times the commuted value as lumpsum,—e.g. If original pension is Rs.1000/, if opted for 33.33% commutation, the pension will be Rs. 667 and the lumpsum amount is Rs. 333 x 100 = 33300. The commutation will not cease and the original pension will not be restored.

If commuted, the pension after commutation will be taken as ORIGINAL Pension for the calculation of lumpsum amounts related to Capital Return.

2. Capital Return

Three types of Capital Return Options are there:(The Capital Return Amounts are ADDITIONAL to all other usual benefits)

Option No. 1 [under para 13(1)(1)]

If opted, 10% of pension will be reduced. If original Pension is Rs. 1000/-, you get monthly pension of Rs. 900/-.	On Member Pensioner's Death, Rs. 1000 x 100 (hundred times of pension) as lump sum will be paid to nominee (Nominee can be anyone including spouse).	Widow pension & 2 Children Pension will be paid as usual.

Option No. 2 [under para 13(1)(2)]

If opted, 10% of pension will be reduced. If original Pension is Rs. 1000/-, you get monthly pension of Rs. 900/-.	On Member Pensioner's **Death,** 80% of pension will be given to widow in addition to her entitled widow pension	And on the death or remarriage of widow, Rs. 1000 x 90 (ninety times of pension) to nominee as lumpsum (nominee cannot be spouse)	Widow pension & 2 Children Pension will be paid as usual.

Option No. 3 [under para 13(1)(3)]

If opted, 12.5% of pension will be reduced. If original Pension is Rs. 1000/-, you get monthly pension of Rs. 875/-. **This amount will be paid for a fixed period of 20 years only.**	In case the member dies before 20 years, the pension will be paid to his nominee **for the balance period.**	On attaining this 20 years, Rs. 1000 x 100 (hundred times of pension) will be given to the member if he is alive, otherwise to his nominee.	Widow pension & 2 Children Pension will be paid as usual.

Types of Pension

Type of Pension	Description
Superannuation	• If age is 58 years or more • 20 years or more service
Retirement	• If age is between 50 and 58 years • 20 years or more service
Short Service (Cessation)	• If age is above 50 years • 10 to 20 years of service
Death while in Service	• Atleast 1 month of service
Death away from Service (Now not in service)	• Age less than 58 years • Holding valid Scheme certificate or proof of service
Nominee Pension	• If no family member, Father or Mother • Member can nominate a person while in service
Parent Pension	• If no family member (i.e. no spouse, offspring) • If no Nomination and to one of the Dependent Parent if alive
Disability Pension	• Certificate to the effect of permanent and 100% disability should be produced • Commutation not applicable

More detailed calculation of pension and tables relating to the calculation of pension

For a member who joined EPF before 15.11.1995 there are 3 components in Pension calculation:

(a) Past Service Benefit; (b)Pensionable Service Benefit; and (c) Proportionate Reduction

For those who joined after 15.11.1995, only the 2nd component, viz. Pensionable Service Benefit is applicable

1. Past Service Benefit: depends upon the wage as on 15.11.1995 and the service rendered in FPF '71 (i.e. upto 15.11.1995) is as shown below :

TABLE-A		
Past Service	**Benefit in Rs.** Wages as on 15.11.1995 is upto Rs.2500/	**Benefit in Rs.** Wages as on 15.11.1995 is more than Rs.2500/-
Upto 11 years	80	85
More than 11 years but upto 15 years	95	105
More than 15 years but less than 20 years	120	135
Beyond 20 years	150	170

The above amount is the benefit payable on completion of 58 years of age as on 16.11.1995.

For the calculation of pension benefits before 58 years (if a member does not complete 58 years of age on 15.11.1995, his past service benefit will be increased by the below factor - Early pension cases) the above benefit is multiplied by the TABLE - B factor to arrive at the past service benefit.

TABLE - B

If Years to 58 of age from 15.11.1995 is:	Then factor is:
less than 1 year	1.049
less than 2 years	1.154
less than 3 years	1.269
less than 4 years	1.396
less than 5 years	1.536
less than 6 years	1.689
less than 7 years	1.858
less than 8 years	2.044
less than 9 years	2.248

less than 10 years	2.473
less than 11 years	2.720
less than 12 years	2.992
less than 13 years	3.29
less than 14 years	3.621
less than 15 years	3.983
less than 16 years	4.381
less than 17 years	4.819
less than 18 years	5.301
less than 19 years	5.810
less than 20 years	6.414
less than 21 years	7.056
less than 22 years	7.761
less than 23 years	8.537
less than 24 years	9.390

2. Pensionable Service Benefit

$$\frac{\text{pensionable salary X pen.service}}{70}$$

subject to minimum of Rs.335, Rs. 438, Rs.635 for receiving early pension (before 58 years) for date of commencement of pension between 01/04/1993 and 15/11/2000, 16/11/2000 and 15/11/2005, 16/11/2005 respectively.

AND

subject to minimum of Rs.635, Rs.438, Rs.335 for receiving pension on or after 58 years for date of commencement of pension between 01/04/193 and 15/11/2000, 16/11/2000 and 15/11/2005,16/11/2005 respectively.

(If a member has joined after 15.11.1995, only Pensionable Service Benefit is applicable)

3. Proportionate Reduction : This arises if the past service is less than 24 years and aggregagte pension calculated is less that Rs.500/-

Pension in case of Member's Death

Death when NOT in service

- If a member dies even when not in service, holding a valid scheme certificate and not completed 58 years of age.
- If unmarried, pension to nominee or to dependent parent is payable only when the member has rendered 10 years of service

Death while in Service

- Member should complete atleast one month's service
- If unmarried, pension to nominee or to dependent parent is payable without any other conditions

Note : In case of died member having family, pension is payable to (1) the spouse and (2) two children below 25 years of age. When a child reaches 25 years of age, the third child below 25 yrs of age will be given pension and so on.

– If the child is disabled, he may get pension till his death.

– In any case, only 2 children will receive pension at a time.

In case of a member not having family, pension is payable to single nominated person.

– If not nominated and having dependend parent, pension is payable first to Father and then on father's death to Mother.

Pension Scheme membership

1. If you are an EPF member after 15.11.1995, you will be automatically a member of Pension Scheme (EPS-95).
2. If you exited from EPF before 16.11.1995, you may or may not be a Pension Scheme Member.

If You have not yet opted for Pension Scheme
You cannot be a Pension Scheme Member If:

1 you settled your EPF Account before 16.11.1995

2 you were not a member of Old Family Pension Scheme-1971 You can be a Pension Scheme Member If:

1 you were a member of Old Family Pension Scheme-1971

Frequently Asked Questions

(a) I do not want this pension. I want money back

If your total service is less than 9.5 years, you can apply for Pension Fund Money back (withdrawal benefit), i.e. as you are not entitled for pension, you may withdraw that amount. The withdrawal benefit calculation (as in the case of Pension Calculation) depends on Average salary and total service, NOT related to your actual Balance in Pension Fund.

EPF Pension scheme is a very liberal insurance to your life after job. In case you die before 58 years of age after contributing to EPF Pension scheme for atleast 1 year, your family is entitled for Pension.

You can add services at different companies by applying for Scheme certificate, and if your total service is atleast 10 years, you can get pension from the age of 50 years onwards.

You should think twice before opting for withdrawal benefit

(b) Pension is less, why?

Pension depends on

1. Your contribution to Pension Fund and
2. Your service

If your contribution is less, your pension will be less

Contribution to Pension Fund was only 3.34% of wages before 16.11.1995.(From 16.11.1995, it is 8.33% of wages). You may be drawing very high salary, but your contribution to Pension Fund will be only Rs. 541/- max. This is because, as per EPF scheme, employer has to remit 8.33% of actual salary or of Rs. 6500/- whichever is minimum. (Your company can contribute more **with permission-else there is no use**; while calculating pension, normally, wages will be limited to 6500/- as per prevailing laws)

Example : We may consider a maxium pension case - this will occur only after 16.11.2025 [16.11.1995+35 years])

Your average salary=20,000/- per month

Your service after 15.11.1995=35 years

Then your pension is 6500/2 = Rs. 3250

6 REGULATION OF PENSIONS –AN INTERNATIONAL PERSPECTIVE

1. POSITION IN THE UK

The Pensions Regulator

The Pensions Regulator is the new regulator of work-based pension schemes in the UK. Created under the Pensions Act 2004, which have wider powers and a new proactive and risk-focused approach to regulation.

Their top priority is to tackle risks to members' benefits—they focus their resources on identifying and reducing risks, working with schemes to get them on the right track.

2. POSITION IN THE USA

There are different types of pension schemes in vogue under which there are public as well as private pension funds. The public funds are managed by the state authorities through their controllers (regulators). There are governing legislations too such as Employment Retirement Income Security Act as in the State of Illinois in the US. There are similar legislations in other states as well. These funds are being managed either directly or through specified agencies. For example, in California, the fund management is done through California Public Employee Retirement System—popularly known as Calpers. In some other states all public employees including teachers, police, firefighters, sanitation workers and the like are covered. There are also state sponsored statutorily provided schemes as part of the social contract between the state and the people. These apart, there are 401(k) and such other schemes in the US that constitute a departure from the concept of a guaranteed benefit and link the retirement benefit wholly to the stock market. As for private pension funds, some are managed by the companies themselves

and are confined to their employees. There are other types of schemes extended by mostly through insurance companies and private pension funds.

3. POSITION IN INDIA

India Paves Way For New Pension System

On January 1, 2005, India established the Pension Fund Regulatory and Development Authority (PFRDA). Its primary function will be to oversee the creation of India's new pension system (NPS). The NPS will give private companies the responsibility to compete for and manage pension accounts. India's current pension scheme, the Public Provident Fund (PPF), is managed by the government. Although the NPS will be optional for both public and private employees, the Indian government hopes that a smooth transition will eliminate the need to continue with the PPF.

The PFRDA will create eligibility requirements for potential pension fund managers (PFMs) and will define the number of PFMs allowed in the market. It has the responsibility of ensuring that only quality players become certified. It will also provide a regulatory framework within which PFMs will operate. Employees who choose to invest in the NPS will contribute 10% of their annual salary to a certified PFM, with the government contributing a similar amount. PFMs will provide three types of accounts for investors to choose among: safe, balanced and growth. It is hoped that this move toward privatizing the pension system will both increase rates of saving and capital accumulation, and relieve pressure on the government's fiscal deficit.

The Indian government will shortly confirm how much foreign direct investment it will allow into the new pension system. It previously indicated that it will allow unrestricted FDI to enter the market. It is expected that it will take about a year to get the new pension funds running.

7 NEED FOR PENSION REFORM IN INDIA

The deficiencies of the current pension system in India are as follows:

- Low coverage
- Under performance of Provident Fund schemes
- Investment restrictions
- Administrative difficulties
- Underdeveloped private annuity market
- Increase in the informal workforce is further widening the skewness in the existing structure of pensions, which, in turn, introduces distortions into the labour market.
- The differences in pensions between public and private sector employees as compared to the public sector are wide.

There is an urgent need to:

- Reduce government burden: In India the number of elderly (persons aged 60 and above) is expected to increase by 107%, to 113.0 million by 2016.
- Involve unorganised sector: Barely 34 million (or less than 11%) of the estimated working population in India is eligible to participate in formal provisions meant to provide old age income security. Therefore, almost 90% of India's workforce is not eligible to participate in any scheme that enables them to save for economic security during their old age.
- At present the pension social security system is based on employer and employee contributions, which largely excludes the unorganised sector.

Pension savings accounts represent real and visible property rightsthey are the primary sources of security for retirement. A clear definition of property rights is a reaffirmation of the rights of people to their accretions.

The reform in the pension system and the adoption of a system based on funded defined-contribution Individual Retirement Accounts will have a multi-pronged advantageous effect on the Indian Economy.

- The government's burden of administering pensions will certainly decrease.
- With the entry of private pension fund managers, pension assets will be invested wisely, thus providing a larger amount to individuals at the time of retirement.
- Pensions as an issue will be de-politicised and will become more of an economic issue.
- The development of the pension sector will create a symbiotic relationship with the insurance sector.
- The element of forced saving in-built into the system of mandatory contributions will go a long way in increasing the rate of savings of the household sector which constitutes the largest part of savers in India. The effective mobilisation of these will go a long way to aid capital formation and economic growth.

1. Structure of the New Pension System

Research commissioned by Project OASIS shows that regular savings at the rate of between Rs.3 to Rs.5 per day through the entire working life easily suffices in escaping the poverty line in old age provided the pension assets are invested wisely.

The OASIS Report envisages a hierarchical structure for the pension system in India based on individual retirement accounts (IRA). Individual accounts imply full portability, i.e. the individual would hold on to a single account across job changes across geographical locations. The pension system would constitute:

a. Points of Preference (POPs): which would be post offices and local banks to deal directly with customers. A two-tier system with POPs with good information technology and telecommunications facilities is proposed, which would offer better services.

b. Depository Corporation: which would maintain the database of individual choices of schemes (viz. safe income, balanced income and growing income styles) and convey them to PFMs.

c. Pension Fund Managers (PFMs): which would perform the task of fund management.

d. Annuity Providers: The pension system design proposed here critically relies on annuity providers who convert the lumpsum of assets (attained at retirement) into a regular monthly pension (or a variable annuity) until death. Annuities are a part of the life insurance industry. With the recent liberalisation of entry into life insurance, it is likely that we will see improvements to the extent where annuities are efficiently priced.

   - The basic architecture of the system is hence one where individuals deal with POPs, which carry these instructions to the depository. The depository would maintain the database of all individual accounts as well as the instructions given by each individual. The depository would consolidate individual instructions into blocks of funds, which would be handed over to PFMs. In this system, PFMs would be able to focus purely on fund management.

   - It is emphasised that this 3-tier system yields the lowest transaction costs. But a method could also be devised to facilitate direct interaction between the individuals and PFMs. Hence, in due course, attempts should also be made to phase out the Depository Corporation so as to facilitate direct interaction between individuals and the PFMs on the lines of the Chilean model.

   - As far as the retirement age goes, the Chilean system presents an interesting alternative. The meaning of "retirement" in the PSA system is much different from the traditional one. First, workers can continue working after retirement. If they do, they would receive the pension their accumulated capital makes possible and they would not be required to contribute any longer to a pension plan. Second, workers with sufficient savings in their

accounts to fund a "reasonable pension" (50 percent of the average salary of the previous 10 years, as long as it is higher than the "minimum pension") may choose to take early retirement whenever they wish to.

The retirement age that is established by law is 65 years for men and 60 years for women. The PSA system, on the other hand, allows for individual preferences to be translated into individual decisions that would produce the desired outcome.

One way to facilitate choice making is through user-friendly computer terminals that permit the worker to calculate the expected value of his future pension, based on the money in his account, and the year in which he wishes to retire.

2. Private Management of Accretions through Pension Fund Managers

The model of private pensions should be implemented using private Pension Fund Managers (PFMs). The OASIS report recommends the establishment of 6 Pension Fund Managers (PFMs) so as to simplify choice for individuals. But this objection is misplaced, as, even if individuals themselves do not possess the knowledge of financial instruments, the market forces would enable them to decide to employ a PFM who would make these choices on their behalf. Hence, this number should be determined by the free interplay of market forces. The most efficient fund managers would survive while the rest would be weeded out and hence there should be no cap on their number. In Chile, there is complete free entry for pension fund providers, even if they are foreign companies, provided certain capital requirements are met.

At this point, 19 private companies have received licenses to be pension plan providers for Polish workers. Most of them are alliances of Western and Polish financial institutions such as Aetna, Citibank, Bank Paribas, Credit Lyonnais, Allianz, etc. There is also a pension plan being provided by the Korean conglomerate Daewoo, and by the largest Polish cable TV station, Polsat.

3. Investment Options and Prudential Regulations for PFMs

Each PFM should offer at least 3 different types of investment alternatives:

a) safe income

b) balanced income and

c) growing income styles.

Regulations need to be laid down to harness the rate of return of the asset class and prevent malpractice and defrauding. In addition, assurances also need to be made for ensuring the safety of returns.

Investment Guidelines	Safe Income	Balanced Income	Growth
Government Paper	>50%	>30%	>25%
Corporate Bonds	>30%	>30%	>25%
Domestic Equity	<10%	<30%	<50%
Of which, International Equity		<10%	<10%

Source: OASIS Report

An increase in the rate of interest by 1 percentage point over a lifetime of accumulations increases the terminal wealth of a pension programme by 20%. In India, the funds deposited into pension accounts are invested mostly in government securities and securities under the special deposit scheme. The returns on these are highly limited. It can be proved for the Indian case that the terminal accretions obtained by investing in equities could be greater than those obtained by investing in government bonds. Shortfall probability is the possibility of underperformance of an all-equity option as opposed to the all-bond option. This probability is fairly small for India.

Equity investment is risky but also yields greater return. Hence the strategy to reduce risk and earn maximum return would be to:

(1) Phase out equity exposure after age 50, and

(2) internationally diversify which would greatly reduce risk and volatility. Expected rate of return taken as an average varies only slightly across different countries.

Investment strategy of 100% investment in government bonds:

	Rate of return on GOI bonds	
Terminal Wealth	2%	4%
	Rs. 152,000	Rs. 215,000

Source: OASIS Report

Investment strategy of 100% investment in a NSE-50 Index Fund:

	Real rate of return on GOI bonds	
Equity Premium	2%	4%
10%	507,254	737,654
20%	775,761	1,165,611

Source: OASIS Report

The gain in the case of investment in 100% equity is 2 to 7 times more than in the case of government bonds.

The OASIS report recommends the following strategy to be adopted for three asset classes:

(a) For the first five years, all domestic equity investments should be implemented using index funds on the NSE-50 or the BSE-100 indices only. There should be no "active fund management" (where fund managers have discretionary control on which shares to buy). Pension funds should not engage in off-exchange transactions on domestic equities: this helps ensure a high degree of transparency in all transactions and a lower incidence of murky market practice. These rules would make it possible for pension assets to harness the "equity premium" (the higher return of equities) while suffering from none of

the risks that flow from giving fund managers complete freedom in forming share portfolios.

(b) Investments in corporate bonds should be limited to investment grade corporate bonds in India, which are liquid. Liquidity helps ensure that the secondary market prices of bonds (which are used in valuation of pension assets) are reliable. The definition of a liquid bond should be as follows: the average impact cost (on the most liquid exchange in India) at transaction sizes of Rs.100, 000 should be below 0.3%. Pension funds should not engage in off-exchange transactions on corporate bonds: this helps ensure a high degree of transparency in all transactions and a lower incidence of murky market practice.

(c) International equity investment should only be implemented using index funds.

One of the most outstanding features of the OASIS report has been its belief in investing part of pension funds in international equity. It has been proved that even if passive fund management is adopted, returns can be maximised by investing in international index funds, which are more or less stable and hence involve a lower risk thus guaranteeing safer returns.

The OASIS Report has suggested certain stringent criteria for PFMs such as:

a. In the safe income style, PFMs would have to guarantee that they would not underperform the weighted average returns of all managers in that style by worse than 2% points in a year.

b. Furthermore, the PFM also has to assure that it collects Rs. 10 billion worth of assets within 2 years or its fees would be dropped by 20% in the next year.

These rules are unduly restrictive and arbitrary and signify a total lack of faith in private initiative. When the pension reform was first introduced in Chile similar guarantees were also required from AFPs, but now there are proposals to slowly phase out these guarantees. In Chile it is believed that such clauses led to a misallocation of funds because of the guarantee system and the strict monitoring of their fees, the

AFPs invested only in similar kinds of funds, consequently earning similar returns.

Even if this policy is initially adopted in India to prevent the negative political implications of having a brand new pension system with wide disparities in the results that it provides, slowly as the pension system matures, these clauses should be phased out. The long-term implications of such a policy are not advantageous as it would force PFMs to compete on the basis of non-price differentials such as quality of service, etc. and would, in general, hamper the growth of a competitive market for pensions.

An alternate way to ensure safety and transparency without debarring free entry and exit or creating a prohibitive atmosphere is through clearer disclosure and prudential norms.

Different investment alternatives

Active Fund Management (AFM) adds value when fund managers are able to exploit market inefficiencies adequately and pay for the costs of transaction costs and management fees. Active management subtracts value in the absence of such abilities. In addition, AFM also introduces risk in terms of performance of the manager subject to manpower turnover. Active management also introduces greater complexities since regulators have to deal with a variety of trading strategies used by managers.

In contrast, passive fund management harnesses the equity premium reliably by investing in Index funds. These are not vulnerable to volatility and are easier to regulate. An index fund passively replicates the returns of the index. The most useful kind of index is where the weight attached to the capital stock is proportional to its market capitalisation. The simplest method of implementing an index fund is through "full replication" where the portfolio held by the index fund is the same as the index. The most basic foundation of indexation is the stock market index.

A passively managed fund investing both in domestic and international indices shows greater gains than the actively managed domestic fund.

While international diversification sharply reduces risk, it also reduces rates of return accessible to unleveraged investments since equity premium internationally is lower than that of India. The lower volatility of the world

stock market index as compared to the much less diversified NSE-50 index will ensure higher rates of return.

The OASIS report recommends passive fund management using index funds in its recommendations. This, however, seems to be just a half-hearted attempt to the whole privatisation approach. Undeniably, index funds have the following advantages:

(1) If markets are fairly efficient, then it is difficult for active fund managers to obtain excess returns after considering extra fees and costs. Active fund management is a method of trying to earn excess returns. In this process, active fund managers expend resources on fund management and incur trading costs. Index funds lower expenditure by avoiding information collection and processing. Broadly, index funds also engage in smaller trading volumes, which help enhance returns through lower costs of transacting.

(2) There is great difficulty in monitoring the activities of an agent. If a layer of intermediaries in the form of a pension committee is introduced, then incentive schemes need to be devised to make both the committee and the PFM to act in the best interests of workers, which is a highly difficult task in itself.

(3) In the case of quasi-nationalisation of pension accounts, when the bulk of the investment is done in equities, there may be a large political risk where the government can use this control for meeting its political ends.

However, this can be avoided if workers have their own IRAs and are given the choice of choosing a fund manager.

4) A naive comparison of returns across alternative funds is an inefficient way to measure the fund manager's ability, especially when there are significant differences in the levels of risk adopted by different funds. A casual comparison should give way to a more scientific process of evaluation. Hence, for deciding on a pension fund manager, more objective sets of guidelines are required. Active fund managers may be able to fulfil requirements of size, pedigree, etc. at the time of selection but may fall short on grounds of performance, thus blaming the authority for a wrong selection of pension fund

manager. Hence, in the case of pensions, poor asset return should be traced back to poor returns on the index—which would, in turn, infuse greater accountability.

However, the advantages of index funds do not necessarily mean that active fund management is in any way disadvantageous. Index funds themselves impose certain negative externalities:

(1) Distorted cost of capital for index stocks

(2) Inferior corporate governance

(3) Diminished market efficiency

(4) Enhanced concentration in the fund industry

In India, market inefficiencies may still arise on account of:

(1) Poor information access: inferior disclosure laws

(2) Inferior human capital

(3) Higher transaction costs

But this does not mean that the individuals should not be given a choice to try their hand at active fund management. Even though the argument of increased transaction costs may hold good, active fund management in itself has a high educative value and one should not discount the existence of certain enterprising individuals who would be able to use these inefficiencies and earn a higher rate of return on their deposits.

Moreover, individuals themselves should be given a choice of whether they would like to adopt passive or active fund management for their accretions along with the freedom to choose their fund managers. However, there could be an argument that the "moral hazard" problem enters into the picture. That is, in case individuals are backed by too many government-guarantees, then they would be prompted to take more risks than they would ordinarily have taken and hence would opt for the riskier strategy of Active Fund Management. But this problem can easily be avoided. The individuals who are ready to take the chance with active fund management should be allowed to do so at their own risk. Hence, in the three-fold scheme recommended by the OASIS report, an additional active fund management scheme should also be introduced and PFMs should be provided the option of carrying this style too.

To sum up, each of the investment strategies, be it active fund management, passive fund management or investment in indexed equities abroad, has its pros and cons in terms of risks and returns. Ultimately, it is the individual who should be given the opportunities to translate his preferences to reality. On the other hand, as far as PFMs are concerned, efforts should be made to give up the closed approach and allow them freedom to function within a broad regulatory framework.

4. Role of the Insurance Sector

The reform in the pension sector is also closely connected with the insurance sector. The common ground between the two arises from the following considerations:

1. On retirement, pension assets may be invested with annuity providers, who form an important component of the insurance sector.
2. Moreover, both pension fund management and insurance deal with similar kinds of investments, i.e. long term. Hence a reform carried out in one of them will necessarily have a positive external effect on the other and as such both share a symbiotic relationship.

Private pension business is a part of insurance business in India. After nationalisation of the insurance sector in 1956, the Life Insurance Corporation (LIC) of India became the only player. The monopoly of the LIC seriously hampered the development and growth of the private annuity market. The Malhotra Committee (1994), the expert group that studied the insurance sector, suggested opening up of the insurance industry. Following the committee's recommendations, the government liberalised the insurance sector in the year 2000. As a result, private corporations including foreign entities are now being permitted to enter the private pension market.

The Chinese method of combining pension reform with insurance sector liberalisation is a case in point. Pension reform and Insurance deregulation both share a common aim. The insurance sector provides the necessary outlets for investment in annuities and the pension reform provides the momentum for insurance reform. Voluntary funds are usually managed by Life Insurance Cos. The Standard Life Assurance Co. of Britain will be participating in the reforms of the Chinese pension system. Officials at the

Ministry of Labour and Social Security of China have signed an agreement with the British government, welcoming Standard Life Assurance Co. and other British insurance firms to take part in the reforms, said an official of the company's Shanghai branch. The Standard Life Assurance Co. will be sending its best experts to provide technical training and consulting services to China, said Robert Knight, who is in charge of the Asia-Pacific affairs of the company, during a visit to China recently.

Pension reform has thus to go hand in hand with insurance sector reform. The first foreign license was granted to American International Assurance. Twelve other companies have been given license and approximately 100 more are waiting.

The IRDA has recently released investment norms for insurance firms intending to enter the private pension market. The Insurance Regulatory and Development Authority (Investment) Regulations, 2000 (IRDA 2000) suggest that for pension and general annuity business, every insurer shall invest and at all times keep invested assets of Pension Business, General Annuity Business and Group Business in the following manner:

	Type of Investment	Percentage
i)	Government securities, being not less than	20%
ii)	Government securities or other approved securities inclusive of (i) above, being not less than	40%
iii)	Balance to be invested in Approved Investments as specified in Schedule I and to be governed by exposure/ prudential norms specified in Regulation 5	Not exceeding 60%

Note: For the purposes of this sub-regulation:

a. No unapproved investments shall be made.

b. All investments shall be made in graded securities and the grading shall not be less than the 'very strong' rating by a reputed and independent rating agency (e.g. AA of Standard and Poor).

c. Every insurer shall invest assets in securities which are actively traded in any stock exchange in India and which are attributable to segregated funds, in respect of linked business.

The IRDA regulations fall short on many counts:

- The OASIS report recommends a minimum investment in foreign equity, but the IRDA regulations are silent with reference to investment in foreign equity. In 1990, further liberalisation took place in Chile when AFPs were allowed to invest in foreign equities and common stock of corporations. Similar steps also need to be taken in India to enable PFMs to harness the highest rate of returns. As and when the PFMs gain experience, investment ceilings ought to be raised.
- The investment in Government and other approved securities is laid down to be a minimum of 40% in the IRDA regulations. This falls somewhere in between the safe and balanced income styles of the IRDA approach. The regulations of the IRDA approach, therefore, discount the possibility of implementing a growth based pension fund investment scheme.
- The sub-regulations make it amply clear that passive fund management is being favoured over active fund management.

PFMs should be granted adequate flexibility to make their portfolio choices. For example, in Chile, government regulation sets only maximum percentage limits both for specific types of instruments and for the overall mix of the portfolio; and the spirit of the reform is that those regulations should be reduced constantly with the passage of time and as the AFP companies gain experience. There is no obligation whatsoever to invest in government or any other type of bonds. Currently, AFPs are not being allowed to hold more than 45 per cent of assets in governmental instruments and 30 per cent in domestic equities. In 1995, the permitted share of foreign instruments was raised to 10 per cent. Rates of returns of AFPs have been very high, reaching an average of 13.6 per cent in the period of 1981-93.

In India too, the objective behind pension reform should be a strong ideological commitment to increase savings, reduce government burden and strengthen capital markets. Pension reform should not be visualised

as merely another avenue for deficit financing through the sale of government bonds and treasury bills. The success of the new system can be guaranteed only if Pension Fund Managers are allowed to operate and compete in a free atmosphere. The structure of rules needs to be broad and accommodative and should be conducive to fostering healthy competition.

5. Role of Government Guarantees

To reassure the people to switch to the new system, government guarantees play a vital role. These guarantees may take the following 3 forms depending upon the level of 'welfare' functions that the government takes upon itself to perform:

- In Chile the government provides welfare type pension funded from general revenues for workers with fewer than 20 years of contributions.
- When workers with at least 20 years of continuous service do not have enough capital accumulated in their accounts to fund a pension that meets the legally defined minimum pension, the government may add the money necessary to provide that pension.
- Similarly, if the funds in the retirement account of a worker are depleted before a worker dies, then the government may give the worker the minimum pension.

The government guarantees constitute the main element of the transition cost into a new pension system.

6. Administrative Authority

The Indian Pensions Authority (IPA) would oversee the entire working of the system and handle the administration. CII, in a recent press release, suggested that the insurance regulator could also supervise the pensions sector.

7. Removal of Subsidies

The present contribution of 1.16% of wages by the government to the Employees' Pension Scheme should discontinue. Instead, this contribution should be channelled into the National Senior Citizen's Fund as initial

corpus for the first 3 years of incorporation of this Fund. Thereafter, this contribution should be discontinued. In addition, 25% of the premature and lumpsum withdrawal tax on provident funds under the new IRA system should be transferred to this Fund annually.

8. Involving the Unorganised Sector

The absence of a unique social security number in India along with the high costs associated with implementation make it impossible to have a mandatory pension scheme for all. Specifically, with regard to the unorganised sector, the PPF Scheme has clearly failed in attaining its objective of inducing savings. Even the Life Insurance Corporation (LIC) has neglected annuities and pension schemes, which have considerable potential among the self-employed and only 100 million people are covered by provident fund or pensions. LIC has no low premium policies like term or whole life insurance. Instead, it concentrates on expensive endowment policies.

One of the biggest problems of most of the countries that have the experience of a private social security system is the inherent failure of involving the unorganised sector. In the case of workers in the organised sector, the employer contributes part of the contribution. However, this is only implicit and it is the worker who actually bears the entire burden of the contribution. In the light of this matter, it ought not to make a difference to the self-employed. There may be many reasons behind the lack of participation from the self-employed such as:

a. By participating in the private pension system, a self-employed worker would be revealing information that he may want to keep private for income-tax reasons.

b. Wealthy self-employed workers would have other means of providing for their own retirement including self-insurance and access to financial instruments that would provide a better combination of risk and return.

c. It could be more profitable for them to rely on government guarantees. This is another area where the 'moral hazard' problem could come into play and hence, schemes need to be devised to make it more profitable for the self-employed to enter the formal pension system.

9. Misplaced Priority on Tax Incentives

In India only a minuscule proportion of the population pays income tax and other forms of direct tax. Hence the inbuilt tax deduction incentives benefit only these sections while the poorer majority are denied these immunities.

A better idea would be to replace the tax exemption with a tax credit system effect that produces a uniform tax incentive effect for all workers — for example, by providing a direct state contribution to workers' retirement and savings accounts. A similar scheme has been introduced in Czechoslovakia. However, one problem with the scheme has been that it has failed to link tax credit to a minimum contribution or saving rate so as to encourage small amounts of savings. This general approach — called the CET approach — is much superior from a social view. It would eliminate the preferential treatment of the tax paying workers, and could contain the tax cost of these exemptions or could achieve greater redistribution in favour of low-income workers for a given tax cost and would also encourage them to save.

10. Early Withdrawals

One of the main problems of the pension schemes in India is the problem of premature withdrawals, which more than often results in poverty during old age. As of now, there is no incentive to compel people to keep their savings till the maturity period and the tax incentives provided are the same even if withdrawals are made. The OASIS report suggests the abolition of tax on earnings of over 12 per cent in Provident Fund and levy of tax, at least of 10 per cent, on early withdrawal from Provident Funds.

In this aspect an important lesson may be learnt from Singapore. In Singapore, the funds for different purposes are segregated as far as possible, and therefore, a cap on premature withdrawal is ensured. Employees have a property right to the funds accumulating in their accounts and are able to withdraw funds for the purchase of a home, to buy life insurance or home mortgage insurance, and may borrow money from their account to pay for the college education of a family member. The designation of separate funds has achieved phenomenal results for Singapore, e.g. the highest rate of home ownership in the world (85%).

11. Inflation Indexing

The National Old Age Social Security programme provides a monthly pension of Rs. 75 to the poorest 30% of the elderly. However, this contribution is highly meagre in the light of the present times. The argument for price indexation is that the old people are less able to adapt to falling incomes than young people are. Canada, UK and US have pensions indexed to prices. If pensions were indexed to wages, then changes in pensions would be linked to changes in productivity. In India, it would be a better alternative to enable the old to maintain their current consumption bundle by indexing pensions to prices. Using price rather than wage indexation would also help dampen the contribution rate increase and the wage increases may be put to use for other purposes.

12. Financing the Transition Cost

The transition cost for a new pension system may be three-fold:

a. Cost of paying the workers who chose to remain within the old system.

b. Cost of reimbursing those who chose the new system.

c. Cost of the 'safety net' provided by the government.

This cost can be best borne in India by privatising the State Owned Enterprises. In such a case, Pension Fund Managers may also participate actively in buying shares of the companies being privatised. This would give workers the possibility of benefiting handsomely from the enormous increase in productivity of the privatised companies by allowing them, through higher stock prices that increases the yield of their PSAs, to capture a large share of the wealth created by the privatisation process.

Conclusion

A reform in the pension system is a long drawn out process, which requires ideological commitment in the first place. Ironically, it is the largest communist country of today that stands as a shining illustration to such commitment. In China, after Document 26 laid down the general features of a 3-pillar system of pensions, local experiments have been allowed to proceed. China is not following a top down blue print approach. The Chinese way of issuing broad central directives, letting local experiments proceed, then changing the central directives in the light of experience

and then experimenting anew and so on is a unique process without close parallel elsewhere.

E.g. Liaoning is a province of 40 million people and the centre of a rusty industrial belt. Nearly one fifth of the province's overall financial expenditures were used to cover insurance payments, which the governor described as "really a heavy burden". This province has been chosen to implement a pilot project based on the 3-pillar scheme.

Similarly, in India also, the key word for pension reform is flexibility. This implies that maximum room needs to be provided for local experiments. Rules need to be laid down clearly, but their number and level of stringency should not be overwhelming. In the long run, there needs to be a commitment to phase out most of the detailed rules, leaving only a broad framework to act upon.

8 NEW PENSION SYSTEM IN INDIA

On January 1, 2005, India established the Pension Fund Regulatory and Development Authority (PFRDA). Its primary function will be to oversee the creation of India's new pension system (NPS). The NPS will give private companies the responsibility to compete for and manage pension accounts. India's current pension scheme, the Public Provident Fund (PPF), is managed by the government. Although the NPS will be optional for both public and private employees, the Indian government hopes that a smooth transition will eliminate the need to continue with the PPF.

The PFRDA will create eligibility requirements for potential pension fund managers (PFMs) and will define the number of PFMs allowed in the market. It has the responsibility of ensuring that only quality players become certified. It will also provide a regulatory framework within which PFMs will operate. Employees who choose to invest in the NPS will contribute 10% of their annual salary to a certified PFM, with the government contributing a similar amount. PFMs will provide three types of accounts for investors to choose among: safe, balanced and growth. It is hoped that this move toward privatizing the pension system will both increase rates of saving and capital accumulation, and relieve pressure on the government's fiscal deficit.

The Indian government will shortly confirm how much foreign direct investment it will allow into the new pension system. It previously indicated that it will allow unrestricted FDI to enter the market. It is expected that it will take about a year to get the pension funds running.

New Pension Scheme Still in a Limbo

One of the major problems facing many countries is the mess in the finances of pension schemes of both the private and public sectors.

In our case, the problem got recognised before it became a crisis, and the central government switched to a defined contribution scheme for future employees, effective from January 1, 2004.

Many state governments have followed suit. But, even as we cross 2005, the enabling legislation is still to be placed before Parliament - and will not be, even in the current session, because of opposition from the Leftist allies of the United Progressive Alliance.

In the meantime, contributions to the new scheme are being deducted and reports indicate that over 100,000 employees are already its members. The scheme accounts are apparently being maintained in an ad hoc, temporary form by the Controller General of Accounts and the funds disappearing in the ocean of public finances.

A more permanent accounting and fund management system will have to await the passage of the Pension Bill! In the meantime, it is anybody's guess to what extent the accounts are in a mess.

Problems of reconciliation leading to frauds, defalcation and corruption surely will also crop up one day. It seems that reconciliation of government accounts for instance, between the tax paid in a bank or treasury, and the amount reported in the tax return — is less than satisfactory.

Indeed, tardy and inefficient implementation of schemes has always been, and remains, the bane of even good policies. The new pension scheme is unlikely to be an exception.

Curiously, even as most analysts remain sceptical about the honest and efficient implementation of the employment guarantee scheme, the UPA announced its intention to start a pension scheme for workers in the unorganised sector.

Surely, we should wait at least till the much more limited new pension scheme has some kind of functioning accounting and fund management structure.

This is, of course, not to deny that the workers in the unorganised sector need some kind of retirement benefits: 89 per cent of the population remains dependent on the age-old joint family system, which is breaking down. And, the number of senior citizens is growing rapidly with increase in life expectancy, and is estimated at 80/85 million now.

But the question is about the administrative and financial feasibility of providing them retirement benefits now.

To be sure, the problem of pensions is not peculiar to India— indeed, in some ways it is much more virulent in Japan and the European countries experiencing falling populations, simultaneously with an increasing number of retirees.

At some stage, the issue of one generation's burdens having to be met by the next could become politically sensitive. In any case, fiscal resources are running increasingly short of meeting the pension burden. As for private, that is, corporate, pensions, many funds have sustained losses as they had invested significantly large proportion in equities.

But this has led to increased liabilities for the employers, which the companies are finding it difficult to meet in the face of global competition.

With stronger accounting standards, the cost of pensions to corporate balance sheets is becoming a big issue: as a corollary, more funds are investing into structured products and derivatives to increase earnings.

It will be a long time before the issues get resolved. Meantime, back home, whatever are the political differences about the pension scheme, surely steps need to be taken to strengthen the accounting and fund management before it is too late.

9 FREQUENTLY ASKED QUESTIONS ON THE INDIA'S NEW PENSION SYSTEM

How is the new pension scheme different ?

In the past, your retirement savings grew at the administered rate announced by the government, In this new pension scheme, what you get on retirement will depend upon the performance of the private pension fund managers handling your retirement funds. While your contribution to the scheme will be known, how it will grow or what you would finally accumulate for your retirement will be uncertain.

So who will manage these schemes?

Private pension fund managers, mostly established Indian and international players in insurance and mutual funds like LIC, SBI, ICICI, HDFC, Principal, and Templeton, are likely to be the major players in pensions. The new pension companies floated by these institutions will be able to function once they get permission from PFRDAPension Fund Regulatory and Development Authorityand can meet stringent standards in areas such as capital adequacy and track record.

What does the pension scheme offer?

All players will offer a standardised set of three pension options. The first will be a conservative scheme with most of your contributions invested in the debt market, and a small portion invested in equities.

The second option will have a balanced allocation between debt and equity. The third option will be a growth option with a greater part of your contribution going into equity.

What can I expect from this scheme?

This scheme will be completely portable. This means you will have one reference number throughout your working years. Your contributions will keep getting deposited in the account through your life, no matter how

many times you change jobs. A central record-keeping agency will maintain the records of your pension transactions and progress.

You will be able to access your records in a variety of ways, including the Internet. Since all transactions and activities will be in paperless mode, any information you seek, like your present accumulation, will be made available easily.

It will be mandatory for your pension provider to give you regular net asset value (NAV) updates of your pension fund. Thanks to the central record-keeping system, you will be able to switch from one fund to another seamlessly if you find the performance unsatisfactory.

You will be able to operate this scheme by making contributions through banks and post offices, which will be tied up with the pension providers.

Can I change my pension options?

You are likely to get enormous freedom to make such changes. Most probably, you will be allowed to make a certain number of changes during a stipulated period of time, say, in a year. This, however, may come at a nominal cost.

Who can participate in this scheme?

New government employees joining work from 1 January 2004 are mandatorily covered by the scheme. They will now have two accounts: mandatory and voluntary. In the former account, their mandatory pension contributions will be lodged along with a matching contribution from the government.

Contributions to the voluntary account will be flexible but the government will not match the contributionsomething like the GPF. Non-government employees like those in the private sector, the self-employed, and the unorganised sector workers will also be able to participate in this scheme by having the same dual accounts, but with no government contributionemployer contribution in the voluntary account will depend upon the employer.

While no partial and premature withdrawals will be allowed in the mandatory account, withdrawals from the voluntary account will be allowed subject to conditions.

Can I expect higher returns in this scheme? Can I lose money?

The answer to both questions: Yes. While most votaries of the new pension scheme talk about the promise of healthy returns thanks to the freedom that the new system will afford fund managers to perform better, this equally masks the stark truth that that there is the risk of a subscriber getting below-normal returns and even suffering erosion of capital.

Proponents of the scheme argue that mandated regular disclosures of investment performance ensure that you get to know about under-performance very early and can punish the fund manager by switching to a new pension fund. It is another matter that this involves your keeping strict vigil on the progress of you pension fund.

What provisions are there for my money's safety?

The PFRDA will lay down regulations to protect investor interests much like other regulators such as the RBI, Sebi and IRDA have done for banks, stocks, mutual funds and insurance.

The regulations will be included in legislation expected to be passed by the Parliament by the middle of this year. The investment guidelines are likely to veer towards passive management, like taking an equity exposure through index funds without individual stock-specific discretion being given to the fund managers.

What about costs?

You will have to monitor the management fees of your pension provider and see how it compares with others in the industry. After all, the higher the costs of managing your money, the lesser the portion of your contribution invested.

At the same time, PFRDA is expected to put a cap on the fees, just as Sebi has done for mutual funds.

Will I necessarily get the money in the form of annuities after I retire?

Most likely, yes. While details are still being worked out, most of your pension accumulation money will be in the form of annuities.

Other options being explored are taking a part of the money as a lumpsum or as a regulated phased withdrawal.

I am not a government employee. Will I, therefore, not be better off investing in the Public Provident Fund?

This will work only in the short term for non-government employees. Increasingly, the government will make the rates on small savings products and the provident fund closer to market-linked rates. Such a move will thus take much of the shine off them.

Further, the government is likely to provide tax breaks in the new pension scheme to make it attractive.

What happens to EPF and GPF subscribers?

While these organisations have been promising to reform their functioning, do not expect to see results too soon. Of course, if the new pension scheme starts doing well, pressure will mount on these organisations to get their act together.

In the medium term, say, 6 to 10 years, you can expect the PFRDA to regulate the existing schemes with new regulations. In that sense, the new scheme is a taste of things to come.

I am not financially savvy. How do I make the right choice?

In the short term, you are unlikely to get quality advice. Potential pension players will point out that is 'great pan-India' reach. We all know that is untrue. In any case, agents of a pension provider can give information, maybe motivated information, about their products but not customised advice.

You will just have to wait till banks get interested in providing retail investment advisory services so that a whole class of financial planners comes up. Till then, keep yourself as well informed as possible.

10 ACCOUNTING FOR PENSIONS: NEW DEVELOPMENTS

Indian Scenario

In India, the accounting for pensions is guided by the provisions of AS 15 (revised 2005)," Employee Benefits ".

An Executive Summary of AS 15 (Revised 2005) is provided in Annexure 2. Full Text of the Accounting Standard has been published in March 2006 issue of the Institute's Journal **The Chartered Accountant.** Full text of the Accounting Standard is also available in the Institute's website at www.icai.org.

International Scenario

Recently, the Accounting Standards Board (ASB) of the Institute Chartered Accountants of England and Wales (ICAEW) has announced that it would undertaking a research project into the financial reporting of pensions.

The ASB's standard on accounting for pensions, Financial Reporting Standard (FRS) 17 'Retirement Benefits', was published in November 2000, although its requirements have only become mandatory in full for accounting periods beginning on or after 1 January 2005. The recent implementation of FRS 17 has given rise to a number of comments about the accounting for pensions, particularly in respect of defined benefit pension arrangements, which have attracted a good deal of media attention.

Accounting to a Press Release issued by ASB of ICAEW the legal and regulatory environment for company pension schemes (in United Kingdom) has also changed significantly since the publication of FRS 17, notably as a result of the Pensions Act 2004. Regulatory changes include the following:

(a) there is a new statutory obligation on solvent companies to meet their pension obligations;

(b) the establishment of the Pension Protection Fund (PPF) to provide a partial safety net for employees whose employers are unable to meet their pension obligations; and

(c) the establishment of The Pensions Regulator (TPR), a new regulator with significant new powers.

These changes could not have been anticipated when FRS 17 was developed and may have an effect on the relevant financial reporting.

Debate has also been stimulated by the move to International Financial Reporting Standards (IFRS). In many respects, the requirements of FRS 17 are similar to those of its international counterpart, the International Accounting Standard (IAS) 19 'Employee benefits'. But there are some issues that are addressed by IAS 19 and not by FRS 17, and there are a number of optional accounting treatments in IAS 19 the merit of which requires careful evaluation.

The International Accounting Standards Board (IASB) and US Financial Accounting Standards Board (FASB) have indicated that they may be reviewing their standards on pensions in the reasonably near future.

The ASB of ICAEW is undertaking its research into pensions accounting in the light of these developments. The research proposal of ASB of ICAEW is anticipated to help inform any proposals for future accounting standards (either UK or international).

There is also an important European dimension of the research proposal of the ASB of ICAEW. The European Financial Reporting Advisory Group (EFRAG) and European National Standard Setters (NSS) have agreed to work more closely together on 'Proactive Accounting Activities in Europe', in order to improve the input from Europe to the global standard-setting process. EFRAG and the NSS have agreed to start proactive work on four projects, one of which is pensions accounting, where the ASB of ICAEW will take the lead.

Issues identified by ASB of ICAEW

The project would reconsider the fundamental principles of pensions accounting. The salient questions to be addressed by the project are:

(a) How is the relationship between an employer and a pension scheme best reflected in the employer's financial statements?

(b) How should the employer's liability in respect of pensions be quantified? In particular:

- what is the most appropriate actuarial method?
- should the employer's liability reflect future salary increases?
- what discount rate should be used to translate future cash flows into a realistic present value?

(c) What is 'the expected return on assets', and how (if at all) should it be reflected in the employer's financial statements?

(d) What is the impact on financial reporting of pension fund regulation arrangements, such as the introduction of the PPF levy?

(e) Are the disclosures required by current standards appropriate? This will include consideration of whether liabilities that might arise in the event of a takeover of the employer are adequately disclosed under current requirements.

The research would also cover the financial reports of pension schemes, including consideration of whether requirements for the accounts of pension schemes secure adequate reporting of liabilities to pay pensions.

Managing the Project

To assist in this research, it is understood that the ASB is forming a Pensions Advisory Panel in the UK, with members who can provide a variety of expert perspectives on pensions accounting, including those of actuaries, the preparers and users of financial statements and regulators. The role of the Panel would be to ensure that a number of knowledgeable points of view are fully considered. There would also be an European working group which would bring broad European experience to the project. The views of Panel and working group members would be fully reported to and debated by the ASB of ICAEW, but the prime responsibility for the research would rest with the ASB of ICAEW. Details of the Panel and working group membership are expected to be made available on the ASB of ICAEW website. It is expected that the research would be published in the course of 2006. The ASB of ICAEW hopes that it would contribute to the development of improved international accounting standards, which might provide a suitable basis for a replacement for FRS 17. Other than a proposal to extend FRS 17 to cover termination benefits, the ASB of ICAEW has no current plans to revise the requirements of FRS 17 before proposals

for a new international standard are made. The ASB of ICAEW will review that plan in the light of the research project and its policy on converging UK standards with IFRS.

Announcing the launch of the research project, ASB of ICAEW Chairman, Ian Mackintosh said that accounting for pensions remains one of the most important and controversial areas of financial reporting. While FRS 17 stands comparison with any other pension accounting standard in the world, the scale and significance of the changes that have taken place since the standard was published has led us to conclude that the time is right for a fundamental review. Mr. Mackintosh hoped that their research would assist in the further development of international accounting for pensions which would lead to a sound basis for UK convergence.

11 TAXATION OF PENSIONS

1. Definition of salary:

SECTION 17 of Income Tax Act 1961:

- "Salary" includes wages, fees, commissions, perquisites, profits in lieu of, or, in addition to salary, advance of salary, annuity or pension, gratuity, payments in respect of encashment of leave, etc.
- It also includes the annual accretion to the employee's account in a recognized provident fund to the extent it is chargeable to tax under Rule 6 of Part A of the Fourth Schedule of the Income-tax Act. Contributions made by the employer to the account of the employee in a recognized provident fund in excess of 12% of the salary of the employee, along with interest applicable, shall be included in the income of the assessee for the previous year.
- Any contribution made by the central government to the account of the employee under the New Pension Scheme as notified vide Notification No. F. No. 5/ 7/2003- ECB & PR, dated 22-12-2003 (copy enclosed as Annexure-VA) and referred to in Section 80CCD shall also be included in the salary income.
- Other items included in salary, profits in lieu of salary and perquisites are described in section 17 of the Income-tax Act. The scope of the term "profits in lieu of salary" has been amended so as not to include interest on contributions or any sum received under a Key Man insurance policy including the sum allocated by way of bonus on such policy. For the purposes of this sub-clause, the expression Key Man insurance policy shall have the meaning assigned to it in clause (10D) of Section 10.
- It may be noted that, since salary includes pensions, tax at source would have to be deducted from pension also, if otherwise called for. However, no tax is required to be deducted from the commuted portion of pension.

2. Pension

- Pension is normally paid to retired employees on a monthly basis. However, certain employers allow the pension to be fully or partly commuted i.e. a lumpsum payment is made to the employees. The treatment of the commuted, pension and the periodical monthly pension received is as under:
- The periodical monthly pension is fully taxable in the hands of all the employees irrespective of the fact that the employee is a government employee or a non-government employee.
- Commuted pension in the case of government employee is fully exempt under Sec. 10A of the Income Tax Act. Hence, no part of the commuted pension is included under the head "Income from Salary."
- Supreme Court/High Court Judges will be entitled to exemption of the commuted portion not exceeding one-half of the pension under Section 10(10A)(ii)Circular : No. 623, dated 6-1-1992.
- Commuted pension in the case of non-government employees is exempt under Sec.10A to the following extent. This exemption is linked to the receipt of gratuity.
- In the case of non-government employees, if the employees receive gratuity the commuted value of 1/3 rd of the entitled pension is exempt from tax. Any amount received over and above the exempted pension is taxable and hence included in gross salary for the purposes of taxation.
- In the case of non-government employees, if the employee does not receive any gratuity which is exempt from tax, commuted value of one half of such pension is not taxable.
- Any payment in commutation of pension received from an approved fund of the LIC of India set up after 1.8.96

3. The Income Tax Act and Life Insurance Policies

- Under Section 10(10A) (iii) of the Income Tax Act, any payment received by way of commutations of pension out of the Jeevan Suraksha annuity plans is exempt from tax

- Under Section 10(10D), any sum received under a life Insurance policy (not being a **Key Man** policy) is also exempt from taxation. But it is wise to remember that Pensions received from **Annuity** plans are **not exempted** from Income Tax.
- Under Section 10(13), the payments received from an approved Superannuation Fund made
  - on the death of a beneficiary
  - to an employee in lieu of or in commutation of an annuity on his retirement or after a specified age.
  - by way of refund of contributions on the death of a beneficiary, etc. are exempt from income tax.
- Section 80 CCC provides a deduction of up to Rs.10,000/- to an individual assessee for any amount paid or deposited to effect or keeping in force any annuity plan of LIC for receiving pension from the fund referred in Sections 10 (23AAB). Presently LIC's **Jeevan Suraksha** plan is one such plan using such benefit.

But you must always keep a few factors in mind when considering Section 80 (CCC)

- Where the assessee or his nominee surrenders the Annuity before its maturity, then the surrender value shall be taxable in the hands of the assessee or his nominee in the year of receipt.
- The amount of pension received will be taxable in the hands of the assessee or nominee. Additionally, you can also get deduction from income under the new Section 80 C of the Income Tax Act for the premiums paid.

4. Contributions to Family Pension Fund under E.P.F. Act

The provision contained in Section 80C(2)(a)(ii) is wide enough to include the contributions made towards the family pension fund established by a scheme under the Employees' Provident Fund and Family Pension Fund Act, 1952, for determining the aggregate of sums qualifying for deduction under Section 80C(1).Circular No. 194 [F. No. 167/37/71-IT(A-I)], dated 20-3-1976.

The income chargeable under the head "Income from other sources" shall be computed after making the following deductions, namely:

in the case of income in the nature of family pension, a deduction of a sum equal to thirty-three and one-third per cent of such income or fifteen thousand rupees, whichever is less.

Explanation: For the purposes of this clause, "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death

5. Section 80C w.e.f. 1-4-2006(Asst.yr. 2006-07)

The following Section 80C shall be re-introduced by the Finance Act, 2005, w.e.f. 1-4-2006 :

(i) as a contribution by an individual to any pension fund set up by any mutual fund notified under clause (23D) of Section 10 or by the administrator or the specified company, as the central government may, by notification in the Official Gazette, specify in this behalf;

(ii) as subscription to any such deposit scheme of, or as a contribution to any such pension fund set up by, the National Housing Bank established under Section 3 of the National Housing Bank Act, 1987 (53 of 1987) (hereafter in this section referred to as the National Housing Bank), as the central government may, by notification in the Official Gazette, specify in this behalf;

Deduction in Respect of Contribution to Certain Pension Funds, 80CCC

(1) Where an assessee being an individual has in the previous year paid or deposited any amount out of his income chargeable to tax to effect or keep in force a contract for any annuity plan of Life Insurance Corporation of India 70[or any other insurer] for receiving pension from the fund referred to in clause (23AAB) of section 10, he shall, in accordance with, and subject to, the provisions of this section, be allowed a deduction in the computation of his total income, of the whole of the amount paid or deposited (excluding interest or bonus accrued or credited to the assessee's account,

if any) as does not exceed the amount of ten thousand rupees in the previous year.

(2) Where any amount standing to the credit of the assessee in a fund, referred to in sub-section (1) in respect of which a deduction has been allowed under sub-section (1), together with the interest or bonus accrued or credited to the assessee's account, if any, is received by the assessee or his nominee

(a) on account of the surrender of the annuity plan whether in whole or in part, in any previous year, or

(b) as pension received from the annuity plan,

an amount equal to the whole of the amount referred to in clause (a) or clause (b) shall be deemed to be the income of the assessee or his nominee, as the case may be, in that previous year in which such withdrawal is made or, as the case may be, pension is received, and shall accordingly be chargeable to tax as income of that previous year.

(3) Where any amount paid or deposited by the assessee has been taken into account for the purposes of this section,

(a) a rebate with reference to such amount shall not be allowed under Section 88 for any assessment year ending before the 1st day of April, 2006;

(b) a deduction with reference to such amount shall not be allowed under Section 80C for any assessment year beginning on or after the 1st day of April, 2006.

7. Deduction in Respect of Contribution to Pension Scheme of Central Government, 80CCD

(1) Where an assessee, being an individual employed by the central government on or after the 1st day of January, 2004, has in the previous year paid or deposited any amount in his account under a pension scheme notified or as may be notified by the central government, he shall, in accordance with, and subject to, the

provisions of this section, be allowed a deduction in the computation of his total income, of the whole of the amount so paid or deposited as does not exceed ten per cent of his salary in the previous year.

(2) Where, in the case of an assessee referred to in sub-section (1), the central government makes any contribution to his account referred to in that sub-section, the assessee shall be allowed a deduction in the computation of his total income, of the whole of the amount contributed by the central government as does not exceed ten per cent of his salary in the previous year.

(3) Where any amount standing to the credit of the assessee in his account referred to in sub-section (1), in respect of which a deduction has been allowed under that sub-section or sub-section (2), together with the amount accrued thereon, if any, is received by the assessee or his nominee, in whole or in part, in any previous year:

(a) on account of closure or his opting out of the pension scheme referred to in sub-section (1); or

(b) as pension received from the annuity plan purchased or taken on such closure or opting out,

the whole of the amount referred to in clause (a) or clause (b) shall be deemed to be the income of the assessee or his nominee, as the case may be, in the previous year in which such amount is received, and shall accordingly be charged to tax as income of that previous year.

(4) Where any amount paid or deposited by the assessee has been allowed as a deduction under sub-section (1), no rebate with reference to such amount shall be allowed under Section 88.

The following sub-section (4) shall be substituted for the existing sub-section (4) of section 80CCD by the Finance Act, 2005, w.e.f. 1-4 2006 :

(5) Where any amount paid or deposited by the assessee has been allowed as a deduction under sub-section (1),

(a) no rebate with reference to such amount shall be allowed under Section 88 for any assessment year ending before the 1st day of April, 2006;

(b) no deduction with reference to such amount shall be allowed under Section 80C for any assessment year beginning on or after the 1st day of April, 2006.

Explanation: For the purposes of this section, "salary" includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

SECTION 9 -INCOME TAX ACT 1961

Income deemed to accrue or arise in India

Pensions received in India from abroad

Pensions received in India from abroad by pensioners residing in this country, for past services rendered in the foreign countries, will be income accruing to the pensioners abroad, and will not, therefore, be liable to tax in India on the basis of accrual. These pensions will also not be liable to tax in India on receipt basis, if they are drawn and received abroad in the first instance, and thereafter remitted or brought to India.

While the pension earned and received abroad will not be chargeable to tax in India if the residential status of the pensioner is either 'non-resident' or 'resident but not ordinarily resident', it will be so chargeable if the residential status is 'resident and ordinarily resident'Circular : No. 4 [F. No. 73A/2/69-IT (A-II)], dated 20-2-1969.

Relief when salary is paid in arrears or in advance, etc.

Rule 21A. (1) Where, by reason of any portion of an assessee's salary being paid in arrears or in advance or, by reason of any portion of family pension received by an assessee being paid in arrears or, by reason of his having received in any one financial year salary for more than twelve months or a payment which under the provisions of clause (3) of Section 17 is a profit in lieu of salary, his income is assessed at a rate higher than that at which it would otherwise have been assessed, the relief to be granted under sub-section (1) of Section 89 shall be

(a) where any portion of the assessee's salary is received in arrears or in advance or, any portion of family pension is received by an assessee in arrears, in accordance with the provisions of sub-rule (2);

(b) where the payment is in the nature of gratuity in respect of past services of the assessee extending over a period of not less than five years, in accordance with the provisions of sub-rule (3);

(c) where the payment is in the nature of compensation received by the assessee from his employer or former employer at or in connection with the termination of his employment after continuous service for not less than three years and where the unexpired portion of his term of employment is also not less than three years, in accordance with the provisions of sub-rule (4);

(d) where the payment is in commutation of pension, in accordance with the provisions of sub-rule (5); and

(e) where the payment is not in the nature of salary paid in arrears or in advance or gratuity in respect of past services or compensation received at or in connection with the termination of employment or in commutation of pension, in accordance with the provisions of sub-rule (6).

(2)(a) In a case referred to in clause (a) of sub-rule (1), the tax payable by the assessee on his total income of the previous year in which the salary is received in arrears or in advance or, in which the family pension is received in arrears (such salary or family pension being hereafter in this sub-rule referred to respectively as the additional salary or additional family pension, as the case may be, and such previous year being hereafter in this sub-rule referred to as the relevant previous year) shall be reduced by the amount, if any, by which the tax on the additional salary or additional family pension, calculated in the manner specified in clause (b), exceeds the tax or the aggregate tax on the additional salary or additional family pension, calculated in the manner specified in clause (c) or clause (d), as the case may be.

(b) Tax shall be calculated on the total income of the relevant previous year as reduced by the additional salary or additional family pension, as the case may be, as if the total income so reduced were the total income of the assessee, and the amount by which the tax so calculated falls short of the tax on the total income before such reduction shall, for the purposes of clause (a), be taken to be the tax on the additional salary or additional family pension, under this clause.

(c) Where the additional salary or additional family pension, as the case may be, relates to only one previous year, tax shall be calculated on the total income of the said previous year as increased by the additional salary or additional family pension, as if the total income so increased were the total income of the assessee, and the amount by which the tax so calculated exceeds the tax payable by the assessee in respect of the total income of the said previous year shall, for the purposes of clause (a), be taken to be the tax on the additional salary or additional family pension, under this clause.

(d) Where the additional salary or additional family pension, as the case may be, relates to more than one previous year:

   (i) the previous years to which the additional salary or additional family pension relates and the amount relating to each such previous year shall first be ascertained;

   (ii) tax shall, then, be calculated on the total income of each such previous year as increased by the amount relating to such previous year ascertained under sub-clause (i), as if the total income so increased were the total income of that previous year, and the amount by which the aggregate amount of tax in respect of the aforesaid previous years as calculated under sub-clause (ii) exceeds the aggregate amount of tax payable by the assessee in respect of the total income of the said previous years shall, for the purposes of clause (a), be taken to be the aggregate tax on the additional salary or additional family pension, under this clause.

(3) (a) In a case referred to in clause (b) of sub-rule (1), the tax payable by the assessee on his total income of the previous year in which the payment by way of gratuity is received (such previous year being hereafter in this sub-rule referred to as the relevant previous year) shall be reduced by the amount, if any, by which the tax on the amount of the gratuity included in the total income of the relevant previous year, calculated at the average rate of tax applicable to such total income, exceeds the tax on the amount of such gratuity, calculated at the rate of tax determined under clause (b) or, as the case may be, clause (c).

(b) Where the payment by way of gratuity is made in respect of past services of the assessee extending over a period of not less than five years but less than fifteen years:

   (i) the total income of the assessee in respect of each of the two previous years immediately preceding the relevant previous year shall be increased by an amount equal to one-half of the amount of the gratuity included in the total income of the relevant previous year, and the average rate of tax for each of the said two previous years shall be calculated as if the total income so increased were the total income of that previous year; and

   (ii) the average of the average rates of tax for the two previous years immediately preceding the relevant previous year, calculated in accordance with sub-clause (i), shall, for the purposes of clause (a), be the rate of tax determined under this clause.

(c) Where the payment by way of gratuity is made in respect of past services of the assessee extending over a period of not less than fifteen years:

   (i) the total income of the assessee in respect of each of the three previous years immediately preceding the relevant previous year shall be increased by an amount equal to one-third of the amount of the gratuity included in the total income of the relevant previous year, and the average rate of tax for each of the said three previous years shall be calculated as if the total income so increased were the total income of that previous year; and

   (ii) the average of the average rates of tax for the three previous years immediately preceding the relevant previous year, calculated in accordance with sub-clause (i), shall, for the purposes of clause (a), be the rate of tax determined under this clause.

(4) (a) In a case referred to in clause (c) of sub-rule (1), the tax payable by the assessee on his total income of the previous year in which the payment by way of compensation is received (such previous year being hereafter in this sub-rule referred to as the relevant previous year) shall be reduced by the amount, if any, by which the tax on the

amount of the compensation included in the total income of the relevant previous year, calculated at the average rate of tax applicable to such total income, exceeds the tax on the amount of such compensation, calculated at the rate of tax determined under clause (b).

(b) The total income of the assessee in respect of each of the three previous years immediately preceding the relevant previous year shall be increased by an amount equal to one-third of the amount of the compensation included in the total income of the relevant previous year, and the average rate of tax for each of the said three previous years shall be calculated as if the total income so increased were the total income of that previous year; and the average of the average rates of tax so calculated for the three previous years shall, for the purposes of clause (a), be the rate of tax determined under this clause.

(5) (a) In a case referred to in clause (d) of sub-rule (1), the tax payable by the assessee on his total income of the previous year in which the payment in commutation of pension is received (such previous year being hereafter in this sub-rule referred to as the relevant previous year) shall be reduced by the amount, if any, by which the tax on the payment in commutation of pension included in the total income of the relevant previous year, calculated at the average rate of tax applicable to such total income, exceeds the tax on the amount of such payment, calculated at the rate of tax determined under clause (b).

(b) The total income of the assessee in respect of each of the three previous years immediately preceding the relevant previous year shall be increased by an amount equal to one-third of the amount of payment in commutation of pension included in the total income of the relevant previous year, and the average rate of tax for each of the said three previous years shall be calculated as if the total income so increased were the total income of that previous year; and the average of the average rates of tax so calculated for the three previous years shall, for the purposes of clause (a), be the rate of tax determined under this clause.

(6) In a case referred to in clause (e) of sub-rule (1), the Board may, having regard to the circumstances of the case, allow such relief as it deems fit.

12 ROLE OF CHARTERED ACCOUNTANTS IN PENSION PLANS[1]

The backdrop

1. According to the World Bank's document on "India Challenge of Old age income Security" One eighth of world's elderly population lives in India. The vast majority of this population is not covered by any formal pension scheme of the Government or private. Instead, they are dependent on their own earning and transfer from their children. These informal systems of old age income/security are imperfect and increasingly strained. The people above age 60 years have grown at a rapid annual rate of growth of 3.8 percent per annum (75.9 million in 2001 and 55.3 million in 1991) during the period 1991-2001, as against the annual growth of 1.8% for the general population.

2. For the organized sector employees' pension (Provident Fund) the basic structure has been outlined in the Employees Provident Fund & Miscellaneous Provision (EPF&MP) Act 1952, which is administered by an organisation titled the Employees Provident Fund Organisation (EPFO). This Act remained unquestioned for almost four decades without any change in the contribution, administration and benefits being provided under this Act. A major change occurred in 1995, with the conversion of part of defined contribution Employees Provident Fund (EPF) Scheme to a defined benefit scheme in the form of Employees' Pension Scheme (EPS).

3. **The Employees Provident Fund:** 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% of the employee's pay. According to some estimates, the flow of contributions for this scheme in 2002-03 was Rs. 114 billion. As on

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[1] It may be noted that the anticipated role of members of the Institute of Chartered Accountants of India has to be played within the Ethical Framework of the Institute.

31st March 2003, total stock of assets under the control of EPFO was Rs. 1.03 trillion.

4. **The Employees Pension Scheme:** The EPS is also a defined benefit scheme, based on a contribution rate of 8.33% from the employee side to which government makes an additional contribution of 1.16%. EPS was introduced in the year 1995, and is applicable to the workers who entered into employment after 1995. According to some estimates, in the year 2002-03, Rs. 48 billion were contributed into this scheme and the stock of assets of Rs. 450 billion was under the control of the scheme. The benefit under this scheme is available as per the defined formula subject to a maximum of 50% of the wages.

5. **Defined contribution based New Pension System (NPS)** is applicable to Central Government employees appointed on or after 1st January 2004. Some state governments have also issued notifications for implementing NPS for new recruits. NPS is applicable to new recruits of various state governments from the effective date mentioned in their notifications.

6. There are some voluntary pension schemes available for general public but these schemes cover a very small pie of the total population. Two of the important voluntary schemes in operation currently are Personal /Group Pension Plans which are administered by a few insurance companies (under the provisions of IRDA) and by a few Mutual Funds (under the provisions of SEBI) and Public Provident Fund

7. According to some experts presently, the coverage of the formal pension system is very low; coverage under EPFO and other voluntary schemes is around ten per cent; and State and Central Government employees are 2.8 per cent. 87.2 per cent of the workers are today not covered.

8. **New Pension Scheme (NPS) vis-à-vis the role of Chartered Accountants**

   - The contribution and accumulation are tax-exempt upto a limit, but benefits may be taxed as normal income.
   - The existing scheme of pension, General Provident Fund and Gratuity would cease for new entrants to the Central civil services.

- Investment protection guarantees on investments under various pension schemes offered by Pension Funds would be implemented using private financial markets.
- There will be one or more central record keeping agency (CRA).
- There will be multiple pension fund managers licensed by PFRDA and the choice would be with the individual employee to decide which fund manager she would like to go with.
- The participating entities (PFMs, CRA etc.) would give out easily understood information about past performance, so that the individual would able to make informed choices about which scheme to choose.
- Investment Options under various pension schemes will be as under:

Options	Govt. Bonds	Corp Bonds	Equity
A	at least 60%	at least 30%	upto 10%
B	at least 40%	at least 40%	upto 20%
C	at least 25%	at least 25%	upto 50%
D	100%	0	0

The choice of a scheme would rest with the subscriber alone and it would also be possible for the subscriber to allocate assets across these schemes. Full transparency and disclosure of information regarding investments shall be provided. Portability of individual pension account while being transferred from one Government service to another or from private to Government and Government to private will be permitted.

9. **Pension Market in India**

Following are the three powerful forces influencing the demographic characteristics of the future generation of the Indians

- Improvement in healthcare system which has increased the longevity that implies more old people with long life span
- Evolution of the nuclear family system and greater mobility of the people leading to geographical separation of the working successors from the old parents

- Better education and health standards, raising new expectations among the elderly

Neither the existing system nor any anti poverty drive by the Government is enough to solve the old age income security problems. Pension plans offer a lucrative business opportunity to many players, as this area is widely unexploited till date.

In the year 2001 Government of India appointed a group of experts to study the various aspects of extending an organized system of pension to the unorganised sector. The group submitted its report in October 2001. According to this report, the pension market (which includes pensions, provident funds and other small savings i.e. NSC, 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.

The group projected the post reform scenario as under:

Contributions (In Rs bn)	2010	2015	2020	2025
Funded schemes				
EPF EPS	461	696	1023	1498
of which voluntary	8.5%	9.3%	10.1%	11.0%
of total contribution	39	64	103	164
GPF	133	201	295	431
PPF	84	127	186	272
Individual Pension	183	306	513	756
Group Pension	708	824	968	1108
Total contribution	1569	2154	2986	4064

However, according to some sources, a more conservative estimate is that the pension market will be worth about Rs.1808 billion by 2025.

National Data Survey- Indian Market

A unique countrywide survey of unorganised sector was recently conducted by the Department of Economic Affairs, Ministry of Finance

with focus on the Government of India's objective of achieving high voluntary pension coverage among unorganised sector workers, including lower and low level income workers. The Survey was conducted by ORG-MARG –AC Nielsen under Asian Development Bank Technical Assistance project. A sample size of 41940, consisting of 21060 rural and 20880 urban households was taken. Survey was conducted with the following objectives in mind:-

- To identify nature and potential market size (Service Provider)
- Accurate prediction of demand to ensure matching market response (CRA)
- To understand preferences and perception of contributors regarding investment choices (PFMs)

Some of the Key findings of the Survey are given below:-

- People are not saving enough presently to support themselves in retirement and, may as a result fall into poverty in their older age
- Joint and extended family support in retirement will continue to reduce
- Government's capacity to support the indigent aged in the future will continue to be limited
- Longevity is extending there is need to save more for self-support in retirement years

According to the Survey structure of the Indian Workforce at a glance is as under:

- Total workforce : 424.6 million
- Urban workforce : 97.7 million
- Rural workforce : 326.9 million
- Total earners (85.6%) : 363.4 million
- Urban earners (92.4%) : 90.4 million
- Rural earners (83.5%) : 273.0 million
- Total unpaid family workers : 61.2 million
- Urban unpaid family workers : 7.3 million
- Rural unpaid family workers : 53.9 million

There are 307 million earning members of unorganised sector workers (Including salaried workers in small firms). About 40 million are having taxable income and have the capacity to buy annuity. The survey indicates an immediate potential market penetration of about 20 million based on the following criteria:

- Capacity to redirect discretionary expenditure
- High interest in the pension concept shown by the respondents
- Age of potential contributors

Finding in the report focuses on the unorganised sector but it is expected that once the new pension system is introduced other will also join this scheme and the actual market size is likely to be much larger.

Role of Chartered Accountants in Pension Fund Sectors

Chartered Accountants who are always known for their professionalism and their specialized services, may play a vital role to make understand the various technicalities, involved in the new system of the Pensions. CAs can grasp new concepts quickly, and also have the ability to look into the details along with an overall perspective. Moreover, the rigorous training and examination process builds an inherent sincerity towards tasks along with a high level of integrity. Apart from Statutory Audit functions, the role for CAs may range from the computation of pension fund contributions, designing pension plans at the time of retirement or to the taxation of the income derived as Pension fund or to understand the various provisions of the Act.

The emerging pension sector has thrown open challenging careers / roles for the Chartered Accountants in the Strategic services, Finance, Risk Management, Planning and Operations functions in Pension Fund sector such as.

- Strategic Services
- Financial Accounting and Investment Operations
- Expense management
- Corporate Governance
- Designing of the Pension Products

- Management of Portfolio
- Pension Marketing
- Other areas

Strategic Services

These services include designing entry strategies for corporates, joint ventures and other alliances for domestic pension sector organisations, business plans, incorporation related legalities and the like. With appreciable level of industry knowledge CAs can render their services for compliance of requirements with regard to incorporation, capital structuring, investments and for formulation of business plans and strategies. Within this domain the CAs could be adding value to the Corporate Planning and MIS which would involve development of Strategic and Operational plans for the business. Possible roles in this area would include:

- Detailing business plans in line with strategic objectives of the pension fund managers
- Engaging with various business functions for evaluating and defining budgets in line with forecasts
- Identifying information needs of the Company, evaluating data sources and using analytical software tools for publishing the same
- Developing the key performance drivers for the business and monitoring them
- Tracking the market developments and competition to support business strategy.

Financial Accounting and Investment Operations

The other areas of the role of CAs revolve around Financial Accounting and Investment Operations of pension funds, which involve:

- True and Fair Financial Reporting, through process controls including adoption of Indian Accounting Standards like AS 15 on Employee Benefits, wherever applicable
- Liaisoning with Statutory Auditors
- Monitoring accounts and financial reconciliation to ensure accuracy of reporting and plausibility of leakages

- Monitoring Compliance with Sarbanes Oxley Act requirements wherever necessitated
- Investment Deal closures with broking intermediaries
- Monitoring & Reporting on compliance with investment regulations and policies
- Calculation/Verification/Reporting of Net Asset Values wherever applicable
- Preparation of Cash Flow statements, etc.

Expense management

Expense management is critical to organisations involved in pension fund management. The Cost Control function performs continual monitoring, ideates as well as tracks and implements best practice ideas to enable the Company to meet efficient expense targets. In detail, the role involves:

- Defining expense ratios,
- Monitoring actual vs. planned ratios
- Identifying expense items for evaluation of optimisation opportunities
- Liaisoning with pension scheme vendors and buyer functions to optimize deals/negotiation

Corporate Governance

Chartered Accountants are expected to play a crucial role in Corporate Governance aspects of Pension Funds, whether through Internal Audit or other Risk Management or Compliance activities. The inter relationship between the corporate governance and internal audit is well established. Needless to mention that the members of the profession have engaged themselves in the internal audit for long. It has been an area in which Chartered Accountants possess an expertise and can apply it fruitfully. In the emerging scenario, pension companies will be outsourcing these internal audit requirements.

These roles have retained their timeless popularity with Chartered Accountants and Finance specialists as it provides an opportunity for cross-functional learning of operational as well as strategic concerns facing an organisation and regulatory mandates. This function requires a

consulting approach at one level to advise top management on adequacy and effectiveness of controls, and a hands-on approach on another level in terms of driving risk management frame- work across the firm. The role of CAs in this area generally covers

- Risk Assessment of operational concerns facing the organisation vis-à-vis strategic objectives and initiatives particularly the long term nature of pension fund investments. This is a critical area and involves review and audit of the efficiency and adequacy of risk management techniques. Additional areas of roles for CAs are business continuity planning, conducting alternative risk financing feasibility studies and evolving loss minimisation strategies etc. Members of the Institute will find these functions stimulating.
- Creating an audit framework and ensuring audit across organisation for processes, systems and compliance related issues and providing feedback
- Defining a risk management framework which includes management of Information Security, Data privacy and Business continuity concerns and actioning the same
- Reviewing performance vis- à-vis the framework
- Implementing a framework for managing risks in the sales processes, especially considering the large distribution reach through an agency force
- Compliance with regulations and legal requirements
- Communication of Compliance requirements to the Organisation
- Handling Compliance related queries, including participation in product design and vendor contracting

Designing of the Pension Products

As explained in para 8 above, there would be four investment options in various pension schemes available for the beneficiaries. The Chartered Accountants can play a valuable role in developing the features of a pension product. They possess adequate knowledge of the financial and technical aspects pertaining to the industry and can apply their skills to yield well-tailored products incorporating the desired features. They can exploit their financial intuition to quantify the risk element and correlate it with the earnings

of the company to develop a well-defined premium structure. The Chartered Accountant firms can formulate a model pension product grounded on the study of an industry and apprise the companies engaged in pension industry about the development of the same to make them aware of the quality of services, which can be rendered by them to the pension companies.

Management of Portfolio

The management of the portfolio includes the assessment of requirement of funds, identification of various sources of finance, the evaluation of the sources in the light of their cost, availability, timing, etc., reconciling the features of various sources with the needs of the company and the selection of appropriate conjunction of sources. The Chartered Accountants are well equipped with the techniques required to weigh the various sources and thus can provide efficient services to the pension companies as an outside advisory agency. There is invariably a large scope for the disposal of the services of Chartered Accountants in this field.

The pension companies are expected to possess huge amount of funds, which need proper management. The management of the portfolio of a pension company requires the identification of investment avenues, evaluation thereof and the selection of the most appropriate mix of alternatives where the funds of the company can be invested. The selection requires the knowledge of finance-related functions and techniques apart from the in-depth knowledge of the patterns of requirement of funds in the company as well as in the industry as a whole and the (expected) regulations of the PFRDA in this behalf. The Chartered Accountants are well versed with the methods and techniques pertaining to the finance related decision-making including the application of scientific and statistical techniques for the same.

Pension Marketing

The key to success in the market for any pension fund manager is to generate awareness about the pension products among the target market. Though this domain belongs to small savings and insurance agents, CAs, because of their superior knowledge and the ability to render services can enter into agreements with insurance companies to function as Direct Sellers of their products.

Other Areas

Calculation of Pension

In the Employee's Pension Scheme, an amount equal to 8.33% of employer's contribution is required to be contributed. But as we know, this scheme came into effect after 15th November 1995, and the provisions relating to the calculation of pension fund for those who joined before this date is entirely different from those who had joined after 15th November 1995. These complexities can be easily resolved by a qualified professional like Chartered Accountant.

Taxation of Pension

When the pension fund is received at the time of retirement, it becomes taxable in the hands of the employee. The provisions of the Income Tax Act, 1961, which are applicable to taxability of the Pension Fund, can be well explained by Chartered Accountants only. Besides this, CAs can also advise their clients about the various sections relating to calculation of Deduction from the total Income.

Analysis of Pension Fund Schemes

The Chartered Accountant can do cost benefit analyses of the various schemes of the Pension Fund and accordingly suggest their clients (employers / workers) the most economic / secure scheme according to the demographic characteristics.

Inspection of PF Investments

The employees can get the deductions for their PF contributions from the total income only when their contributions are credited in the Recognised Provident Fund. CAs can conduct the audits of the Pension Fund to ensure whether that particular organization is complying the with provisions of the regulations or not.

13 RESOURCE SECTION

www.icai.org

www.en.wikipedia.org

www.citu.org.in/wc

www.incometaxindia.gov.in

www.legalspider.com

www.camagazine.com

www.epfindia.com

www.hdfcinsurance.com

www.permin.nic.in/pension

www.watsonwyatt.com

www.outlookmoney.com

www.sify.com/finance/insurance

www.rediff.com

ANNEXURE I

Pensions Act

I. THE PENSIONS ACT, 1871

(Act No. 23 of 1871)

An Act to consolidate and amend the law relating to pensions and grants by government of money or land-revenue.

[8th August, 1871]

Preamble – Whereas it is expedient to consolidate and amend the law relating to pensions and grants by government of money or land-revenue, it is hereby enacted as follows:-

I. PRELIMINARY

1. Short title.- This act may be called the Pensions Act, 1871.

Extent of the Act.- In so far as it relates to Union Pensions, it extends to the whole of India and in so far as it relates to other pensions, it extends to the whole of India except (the territories which, immediately before the 1st November, 1956, were comprised in Part-b States).

2. Repealed.

3. Interpretation.- In this Act, the expression 'grant of money or land-revenue' includes anything payable on the part of the government in respect of any right, privilege, perquisite or office.

3. A. The expression 'the appropriate government' means in relation to Union Pensions, the central government, and in relation to other pensions, the state government.

II. RIGHTS TO PENSIONS

4. Bar on suits relating to pensions:-Except as hereinafter provided, no Civil Court shall entertain any suit relating to any pension or grant of money or land-revenue conferred or made by the government or by any former government, whatever may have been the consideration for any such

pension or grant, and whatever may have been the nature of the payment, claim or right for which such pension or grant may have been substituted.

5. **Claims to be made to Collector or other authorized Officer**:- Any person having a claim relating to any such pension or grant may prefer such claim to the Collector of the District or Deputy Commissioner or other officer authorized in this behalf by the appropriate government and such Collector, Deputy Commissioner or other Officer shall dispose of such claim in accordance with such rules as the Chief Revenue authority may, subject to the general control of the appropriate government, from time to time, prescribe in this behalf.

6. **Civil Court empowered to take cognizance of such claims:-** A Civil Court, otherwise competent to try the same, shall take cognizance of any such claim upon receiving a certificate from such Collector, Deputy Commissioner or other Officer authorized in that behalf that the case may be so tried, but shall not make any Order or Decree in any suit whatever by which the liability of government to pay any such pension or grant as aforesaid is affected directly or indirectly.

7. Pensions for lands held under grants in perpetuity:- Nothing in Sections 4 and 6 applies to

(1) any *inam* of the class referred to in Section 1 of Madras Act No. IV of 1862;

(2) Pensions heretofore granted by government in the territories respectively, subject to the Lieutenant-Governors of Bengal and the North-Western Provinces, either wholly or in part as an indemnity for loss sustained by the resumption by a native government of lands held under *sanads* purporting to confer a right to perpetuity. Such pension shall not be liable to resumption on the death of the recipient, but every such pension shall be capable of alienation and descent, and may be sued for and recovered in the same manner as any other property.

III. MODE OF PAYMENT

8. Payment to be made by Collector or authorized officer— All Pensions or grants by Government of money or land-revenue shall be paid by the

Collector or the Deputy Commissioner or other authorized officer, subject to such rules as may from time to time, be prescribed by the Chief Controlling Revenue Authority.

9. Saving of rights of grantees of land revenue— Nothing in Sections 4 and 8 shall affect the right of a grantee of land-revenue, whose claim to such grant is admitted by government, to recover such revenue from the persons liable to pay the same under any law for the time being in force for the recovery of the rent of land.

10. Commutation of pensions— The appropriate government may, with the consent of the holder, order the whole or any part of his pension or grant of money or land-revenue to be commuted for a lumpsum on such terms as may be deemed fit.

IV. MISCELLANEOUS

11. Exemption of pension from attachment— No Pension granted or continued by government on political considerations, or on account of past services or present infirmities or as a compassionate allowance, and no money due or to become due on account of any such pension or allowance, shall be liable to seizure, attachment or sequestration by process of any Court at the instance of a creditor, for any demand against the pensioner, or in satisfaction of a Decree or Order of any such Court.

This section applies also to pensions granted or continued after the separation of Burma from India, by the Government of Burma.

12. Assignments, etc., in anticipation of pension to be void— All assignments, agreements, orders, sales and securities of every kind made by the person entitled to any pension, pay or allowance mentioned in Section 11, in respect of any money not payable at or before the making thereof, on account of any such pension, pay or allowances or for giving or assigning any future interest therein are null and void.

12-A. Nomination by pensioner to receive moneys outstanding on account of pension— Notwithstanding anything contained in Section 12 or in any other law for the time being in force

(a) any person to whom any pension mentioned in Section 11 is payable by the Government of India or out of the Consolidated Fund of India

(such person being hereinafter referred to as the pensioner) may nominate any other person (hereinafter, referred to as the nominee), in such manner and in such form as may be prescribed by the central government by rules, to receive after the death of the pensioner, all moneys payable to the pensioner on account of such pension at, before or after the date of such nomination and which remain unpaid immediately before the death of the pensioner; and

(b) the nominee shall he entitled on the death of the pensioner, to receive, to the exclusion of all other persons, all such moneys which have so remained unpaid:

Provided that if the nominee predeceases the pensioner, the nomination shall so far as it relates to the right conferred upon the said nominee, become void and of no effect:

Provided further that where provision has been duly made in the nomination, in accordance with the rules made by the central government, conferring upon some other person the right to receive all such moneys, which have so remained unpaid, in the event of the nominee predeceasing the pensioner, such right shall, upon the decease as aforesaid of the nominee, pass to such other persons.

13. Whoever proves to the satisfaction of the appropriate government that any pension is fraudulently or unduly received by the person enjoying the benefit thereof shall be entitled to a reward equivalent to the amount of such pension for the period of six months.

14. Power to make rules— In each State the Chief Controlling Revenue authority may, with the consent of the appropriate government, from time to time, make rules consistent with this Act respecting all or any of the following matters:

(1) the place and times at which, and the person to whom, any pension shall be paid;

(2) inquiries into the identity of claimants;

(3) records to be kept on the subject of pensions;

(4) transmission of such records;

(5) correction of such records;

(6) delivery of certificates to pensioners;

(7) registers of such certificates;

(8) reference to the Civil Court, under Section 6, of persons claiming a right of succession to or participation in, pension or grants of money or land-revenue payable by government;

and generally for the guidance of officers under this Act.

All such rules shall be published in the Official Gazette, and shall thereupon have the force of law.

15. Power of Central Government to make rules— The Central Government may, by notification in the Official Gazette, make rules to provide for all or any of the following matters, namely:

(a) the manner and form in which any nomination may be made under Section 12-A and the manner and form in which such nomination may be cancelled or varied by another nomination;

(b) the manner in which provision may be made, for the purposes of the second proviso to Section 12-A in any such nomination for conferring on some person other than the nominee the right to receive moneys payable to the nominee in such nominee predeceases the pensioner.

16. Laying of rules— Every rule made by the central government under this Act and every rule made under Section 14 by a Chief Controlling Revenue Authority with the consent of the central government shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions and if, before the expiry of the session immediately following the session or the successive session aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

ANNEXURE II

Executive Summary of Accounting Standard (AS) 15 (revised 2005)

Employee Benefits

(The following is an Executive Summary of AS 15 (revised 2005) containing salient features and principle requirements of Accounting Standard (AS) 15 (revised 2005), Employee Benefits. While applying AS 15 (revised 2005) in practical situation, reference should be made to the complete text of the Accounting Standard.)

Salient features and principle requirements of AS 15 (revised 2005)

1. Accounting Standard (AS) 15 (revised 2005), *Employee Benefits,* comes into effect in respect of accounting periods commencing on or after April 1, 2006 and is mandatory in nature[1] from that date for all enterprises. However, considering limited resources available with the Small and Medium-seized Enterprises (SMEs) to apply AS 15 (revised 2005), relaxations/ exemptions from certain requirements of AS 15 (revised 2005) have been provided to SMEs.

2. AS 15 (revised 2005) prescribes accounting and disclosure for all employee benefits, except employee share-based payments[2]. The Standard identifies four categories of employee benefits:

   (a) short-term employee benefits, such as wages, salaries and social security contributions (e.g., contribution to an insurance company by an employer to pay for medical care of its employees), paid annual leave, profit- sharing and bonuses (if payable within twelve

[1]This implies that, while discharging their attest function, it will be the duty of the members of the Institute to examine whether this Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from this Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviations.

[2] The accounting for such benefits is dealt with in the Guidance Note on Accounting for Employee Share-based Payments issued by the Institute of Chartered Accountants of India.

months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as gratuity, pension, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

(d) termination benefits.

3. AS 15 (revised 2005) requires an enterprise to recognise the undiscounted amount of short-term employee benefits when an employee has rendered service in exchange for those benefits.

4. Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans. Under defined contribution plans, the enterprise's obligation is limited to the amount that it agrees to contribute to the fund and in consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee. AS 15 (revised 2005) requires that when an employee has rendered service to an enterprise during a period, the enterprise should recognise the contribution payable to a defined contribution plan in exchange for that service. All other post-employment benefit plans are defined benefit plans. Defined benefit plans may be unfunded, or they may be wholly or partly funded. AS 15 (revised 2005) requires an enterprise to:

(a) account not only for its legal obligation under the formal terms, but also for any other obligation that arises from the enterprise's informal practices;

(b) determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the

balance sheet date;

(c) use the Projected Unit Credit Method to measure its obligations and related costs;

(d) attribute benefit to periods of service under the plan's benefit formula, unless an employee's service in later years will lead to a materially higher level of benefit than in earlier years;

(e) use unbiased and mutually compatible actuarial assumptions about demographic assumptions (such as, mortality, employee turnover) and financial assumptions (such as discount rate, future salary and benefit levels). Financial assumptions should be based on market expectations, at the balance sheet date, for the period over which the obligations are to be settled;

(f) determine the discount rate by reference to market yields at the balance sheet date on government bonds of a currency and term consistent with the currency and estimated term of the post-employment benefit obligations;

(g) deduct the fair value of any plan assets from the present value of the defined benefit obligation at the balance sheet date. Certain reimbursement rights that do not qualify as plan assets are treated in the same way as plan assets, except that they are presented as a separate asset, rather than as a deduction from the obligation;

(h) limit the carrying amount of a defined benefit asset so that it does not exceed the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan;

(i) recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an enterprise should recognise past service cost immediately;

(j) recognise gains or losses on the curtailment or settlement

of a defined benefit plan when the curtailment or settlement occurs;

(k) recognise immediately actuarial gains and losses in the statement of profit and loss as income or expense; and

(l) make disclosures regarding defined benefit plans.

5. AS 15 (revised 2005) requires an enterprise to classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any obligation that goes beyond the formal terms). When sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an enterprise should account for the plan as if it were a defined contribution plan and make disclosures such as the fact that the plan is a defined benefit plan and the reason why sufficient information is not available to enable the enterprise to account for the plan as a defined benefit plan.

6. AS 15 (revised 2005) requires an enterprise to account for a state plan in the same way as for a multi-employer plan.

7. AS 15 (revised 2005) requires an requires a simpler method of accounting for other long-term employee benefits than for post-employment benefits by requiring that past service cost should be recognised immediately.

8. Termination benefits are employee benefits payable as a result of either: an enterprise's decision to terminate an employee's employment before the normal retirement date; or an employee's decision to accept voluntary redundancy in exchange for those benefits. An enterprise should recognise termination benefits as a liability and an expense when, and only when:

   (i) the enterprise has a present obligation as a result of a past event;

   (ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

   (iii) a reliable estimate can be made of the amount of the obligation.

9. On first adopting AS 15 (revised 2005), the difference (as adjusted by any related tax expense) between the liability (on the date of first adoption) in respect of employee benefits other than termination benefits, determined as per AS 15 (revised 2005) and the liability that would have been recognised at the same date, as per the pre-revised AS 15, should be adjusted against the opening balance of revenue reserves and surplus.

10. In respect of expenditure on termination benefits, though AS 15 (revised 2005) requires immediate expensing; as a transitory measure it is provided that where an enterprise incurs expenditure on termination benefits on or before 31st March, 2009, the enterprise may choose to follow the accounting policy of deferring such expenditure over its pay-back period. However, the expenditure so deferred cannot be carried forward to accounting periods commencing on or after 1st April, 2010.