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ORIGINAL ARTICLE

PERFORMANCE ANALYSIS OF TIER 1 NPS SCHEMES FOR GOVERNMENT EMPLOYEES

M GANGU NAIDU

Research scholar, K L University, Green Fields, Vijayawada

Abstract:

The National Pension System (NPS) is a defined contribution based pension system launched by Government of India with effect from 1 January 2004. Like most other developing countries, India does not have a universal social security system to protect the elderly against economic deprivation. As a first step towards instituting pension reforms, Government of India moved from a defined benefit pension to a defined contribution based pension system. Apart from offering wide gamut of investment options to employees, this scheme would help government of India to reduce its pension liabilities. Unlike existing pension fund of Government of India that offered assured benefits, NPS has defined contribution and individuals can decide where to invest their money. Scheme Preference is the Pension fund schemes option chosen by the subscriber for investing the pension contribution amount. At present, there is only one default scheme for Tier I. The contribution of all the Subscribers will be invested in this default scheme. In the default scheme, the contribution is allocated to three PFMs, viz. SBI Pension Funds Private Limited, UTI Retirement Solutions Limited and LIC Pension Fund Limited in a predefined proportion and each of the PFMs will invest the funds in the proportion of 85% in fixed income instruments and 15% in equity and equity related instruments. For Tier II, the government subscriber has been given the flexibility to choose one out of six Pension Fund Managers (PFMs) and also the percentage in which the selected PFM will invest the funds. For Central Government employees mandatorily covered under NPS, the total contribution uploaded in an employee's Tier I account is divided among three PFMs. in a predefined ratio and units are allotted in the subscribers account. For State Government employees mandatorily covered under NPS, the total contribution uploaded in an employee's Tier I account is divided among the three PFMs. in a ratio as decided by the State Government and units are allotted in the subscribers account accordingly. The PFMs invest the money in different financial instruments within the investment guidelines laid down by PFRDA and declare Net Asset Value (NAV) at the end of each business day. The objective of this report is to analyze the performance of the NPS schemes for central and state government employees.

KEYWORDS:

Asset Classes, Central Government Employees Schemes, Equity market, Net Asset Value, National Pension Scheme, PFRDA, State Government Employees Schemes.

RESEARCH METHODOLOGY

In this study secondary data was collected through instruments structured at different levels. Information was collected about financial and physical performance and adequacy of the implementation mechanism for the schemes. Detailed discussions were held with the officials at various levels to gather information on the implementation of the scheme. Historic NAVs of each of the scheme were collected from the websites of respective PFM. For LIC Pension Fund the daily NAV was available from 1/12/2009 to 31/12/2012, For UTI Retirement Solutions the daily NAV was available from 1/4/2008 to 20/11/2012. For SBI Pension Fund the daily NAV was available from 1/1/2010 to 31/12/2012, though the funds started operations from April 2008 or later, the data since inception was not available from all fund managers.

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Based on the data availability the period was determined as 1/1/2010 to 31/12/2012 cover the 3 calendar years. As UTI Retirement Solutions daily NAV data was available till 20/11/2012 only, the returns for the period are extrapolated to arrive at annual returns for 2012.

OBJECTIVES

The objective of this report is to analyze the performance of the NPS schemes for central and state government employees.
The type of mechanism adopted and arrangements made for planning co-ordination, monitoring and implementation of the scheme.
The extent to which allocations, releases and utilization of funds were made as per the guidelines of the scheme.

INTRODUCTION

The National Pension System (NPS) is a defined contribution based pension system launched by Government of India with effect from 1 January 2004. Like most other developing countries, India does not have a universal social security system to protect the elderly against economic deprivation. As a first step towards instituting pension reforms, Government of India moved from a defined benefit pension to a defined contribution based pension system. Apart from offering wide gamut of investment options to employees, this scheme would help government of India to reduce its pension liabilities. Unlike existing pension fund of Government of India that offered assured benefits, NPS has defined contribution and individuals can decide where to invest their money. The scheme is structured into two tiers:

Tier-I account: You cannot withdraw the amount up to retirement. Government employees have to mandatorily invest 10% of their salary into NPS Tier-1 account. Tier-1 account is mandatory to open for Tier-2 account.

Tier-II account: You can invest and freely withdraw money from this Tier-II account. Minimum contribution is Rs. 1000 during registration and Rs. 2000 for the entire year. You need to contribute at least one contribution per year.
Swavalamban account: This type of NPS is provided for encouraging poor workers. Under this scheme, Govt. of India would pay Rs. 1,000 per year for first 4 years as its contribution. However there are several conditions attached to this.
Scheme Preference is the Pension fund schemes option chosen by the subscriber for investing the pension contribution amount. At present, there is only one default scheme for Tier I. The contribution of all the Subscribers will be invested in this default scheme. In the default scheme, the contribution is allocated to three PFMs, viz. SBI Pension Funds Private Limited, UTI Retirement Solutions Limited and LIC Pension Fund Limited in a predefined proportion and each of the PFMs will invest the funds in the proportion of 85% in fixed income instruments and 15% in equity and equity related instruments.
For Tier II, the government subscriber has been given the flexibility to choose one out of six Pension Fund Managers (PFMs) and also the percentage in which the selected PFM will invest the funds.

The six PFMs are
ICICI Prudential Pension Funds Management Company Limited
IDFC Pension Fund Management Company Limited
Kotak Mahindra Pension Fund Limited
Reliance Capital Pension Fund Limited
SBI Pension Funds Private Limited
UTI Retirement Solutions Limited

Since 1 April 2008, the pension contributions of Central Government employees covered by the National Pension System (NPS) are being invested by professional Pension Fund Managers in line with investment guidelines of Government applicable to non-Government Provident Funds. A majority of State Governments have also shifted to the defined contribution based National Pension System from varying dates. 27 State/UT Governments have notified the NPS for their new employees. Of these, 6 states have already signed agreements with the intermediaries of the NPS architecture appointed by Pension Fund Regulatory and Development Authority (PFRDA) for carrying forward the implementation of the National Pension System. The other States are in the process of finalization of documentation. Pension Fund Regulatory and Development Authority (PFRDA) is the prudential regulator for the NPS. PFRDA was established by the Government of India on 23 August 2003 to promote old age income security by establishing, developing and regulating pension funds. PFRDA has set up a Trust under the Indian Trusts

Act, 1882 to oversee the functions of the PFMs. The NPS Trust is composed of members representing diverse fields and brings wide range of talent to the regulatory framework.

NPS was made available to all citizens of India on voluntary basis and is mandatory for employees of central government (except armed forces) appointed on or after 1 January 2004. All Indian citizens between the age of 18 and 55 can join the NPS.

Tier-I is mandatory for all Govt. servants joining Govt. service on or after 1.1.2004. In Tier I, Govt. servants will have to make a contribution of 10% of his Basic Pay, DP and DA which will be deducted from his salary bill every month. The Govt. will make an equal matching contribution. Since 1 April 2008, the pension contributions of Central Government employees covered by the NPS are being invested by professional Pension Fund Managers in line with investment guidelines of Government. However, there will be no contribution from the Government in respect of individuals who are not Government employees. The contributions and returns thereon would be deposited in a non-withdraw able pension account.

In addition to the above pension account, each individual can have a voluntary tier-II withdraw able account at his option. Government will make no contribution into this account. These assets would be managed in the same manner as the pension. The accumulations in this account can be withdrawn anytime without assigning any reason. It's estimated that 8 crore citizens of India are eligible to join the NPS.

Operational Structure

NPS is designed to leverage network of bank branches and post offices to collect contributions and ensure that there is seamless transfer of accumulations in case of change of employment and/or location of the subscriber. It offers a basket of investment choices and Fund managers. Dhirendra Swarup is one of the founders.

There will be one or more CRA, several PFMs to choose from which will offer different categories of schemes. The participating entities (PFMs, CRA etc.) would give out easily understood information about past performance & regular NAVs, so that the individual would able to make informed choices about which scheme to choose. PFMs would share this common CRA infrastructure. The PFMs would invest the savings people put into their PRAs, investing them in three asset classes, equity (E), government securities (G) and debt instruments that entail credit risk (C), including corporate bonds and fixed deposits.

Contribution Guidelines
The following contribution guidelines have been set by the PFRDA:
Minimum amount per contribution: Rs. 500 per month
Minimum number of contributions: 1 in a year
Minimum annual contribution: Rs 6,000 in each subscriber account.

If the subscriber is unable to contribute the minimum annual contribution, a default penalty of Rs.100 per year of default would be levied and the account would become dormant. In order to re-activate the account, subscriber will have to pay the minimum contributions, along with penalty due. A dormant account will be closed when the account value falls.

Investment Options

Under the investment guidelines finalized for the NPS, pension fund managers will manage three separate schemes, each investing in different asset class. The three asset classes are equity, government securities and credit risk-bearing fixed income instruments. The subscriber will have the option to actively decide as to how the NPS pension wealth is to be invested in three asset classes:

Asset Classes

E Class: Investment would primarily be in Equity market instruments. It would invest in Index funds that replicate the portfolio of either BSE Sensitive index or NSE Nifty 50 index.
G Class: Investment would be in Government securities like GOI bonds and State Govt. bonds
C Class: Investment would be in fixed income securities other than Government Securities
* Liquid Funds of AMCs regulated by SEBI with filters suggested by the Expert Group
* Fixed Deposits of scheduled commercial banks with filters
* Debt securities with maturity of not less than three years tenure issued by bodies corporate including scheduled commercial banks and public financial institutions
Credit Rated Public Financial Institutions/PSU Bonds
Credit Rated Municipal Bonds/Infrastructure Bonds
In case the subscriber does not exercise any choice as regards asset allocation, the contribution will be invested in accordance with the 'Auto choice' option. In this option the investment will be determined by a

predefined portfolio. At the lowest age of entry (18 years) the auto choice will entail investment of 50% of pension wealth in "E" Class, 30% in "C" Class and 20% in "G" Class. These ratios of investment will remain fixed for all contributions until the participant reaches the age of 36. From age 36 onwards, the weight in "E" and "C" asset class will decrease annually and the weight in "G" class will increase annually till it reaches 10% in " E", 10% in "C" and 80% in " G" class at age 55. The following table will illustrates this auto choice more clearly-

Class	Till the of age 35 years	At age 55 Years
E	50%	10%
C	30%	10%
G	20%	80%

INVESTMENT CHARGES

NPS levies extremely low Investment management charge of 0.00010% on net AUM (Asset Under Management). This is extremely low as compared to charges levied by mutual funds or other investment products. Initial charge of opening the account would be Rs. 470. From second year onwards the minimum charge would be Rs. 350 a year. As per the offer document of NPS, annual and transaction charges would be reduced once the number of accounts in CRA reaches 10 lakh.

WITHDRAWAL NORMS

If subscriber exits before 60 years of age, he/she has to invest 80% of accumulated saving to purchase a life annuity from IRDA regulate life insurer. The remaining 20% may be withdrawn as lump sum. On exit after age 60 years from the pension system, the subscriber would be required to invest at least 40% of pension wealth to purchase an annuity. In case of Government employees, the annuity should provide for pension for the lifetime of the employee and his dependent parents and his spouse at the time of retirement. If subscriber does not exit the system at or before 70 years, account would be closed with the benefits transferred to subscriber in lump sum. If a subscriber dies, the nominee has the option to receive the entire pension wealth as a lump sum. Recent changes permit subscriber to continue to remain invested after 60 and up to 70 but subscriber can no longer add further investments. Subscriber to intimate the period of deferment and can not withdraw during the deferment period. If the subscriber does not exit by 70, the lump sum will be monetized and transferred to subscriber's bank account.

TAX TREATMENT

The offer document of NPS does not specify the tax benefits in elaborate manner. It specifies "Tax benefits would be applicable as per Income Tax Act, 1961 as amended from time to time." As per current provisions, withdrawals under the NPS attract tax under the EET (exempt-exempt-taxable) system, which means that while contributions and returns to the NPS are exempt up to a limit, withdrawals would be taxed as normal income (EET). Cessions for contributions made in National Pension System in the budget 2011.

While the NPS subscribers are directly benefited from one of these Income tax concessions, the second one is beneficial to the employers who contribute for NPS each month equivalent to employee's contribution in Tier I.

INCOME TAX CONCESSION TO EMPLOYEES UNDER NPS:

So far, the contribution made by a National Pension System subscriber in Tier I scheme is deductible from the total income under Section 80CCD of the Income Tax Act. Like wise, the contribution made by the employer for the employee in Tier I of National Pension System is also deductible under Section 80CCD. However, the aggregate deduction under Section 80C, 80CCC and 80CCD is fixed at Rs.1 lakh.

So, if the NPS subscriber is already having other eligible deductions such as LIC premium, PPF, bank or NSC deposits, ELSS etc., under Section 80C, 80CCC and Section 80CCD., deduction allowed under Section 80CCD in respect of National Pension System may not be of much useful as the overall limit of savings eligible for deduction is pegged at Rs. 1 lakh.

Further, contribution made by the National Pension System should also be included in the Total income of NPS subscriber as far as calculation of income tax is concerned, while full deduction of the same from income under Section 80CCD may not be possible as other savings made by the subscriber covers the overall limit of Rs.1 lakh under Section 80CCD. Hence, for a NPS subscriber contribution for NPS by the

Government is taxable in most of the cases.

For example, if an employee receives a salary of Rs.40, 000 (payday), 10% of the same (Rs.4000) is paid by him as contribution towards NPS. The Government will also be paying Rs.4000 in this case in NPS fund of the said employee. Until now, an amount of Rs.96, 000 (Rs.48, 000+Rs.48000) could be deductible from the total income as far as this employee is concerned under Section 80CCD.

However, if the said employee has been paying LIC premium of Rs.20, 000 per year, he will be allowed to deduct only Rs.4000 in respect of the same under Section 80CC as total ceiling of Rs.1, 00,000 under Section 80CCE will apply in this case. So, an eligible deduction of Rs.16, 000 could not be availed under Section 80CCD. In other words, employer contribution to NPS to an extent of Rs.16, 000, which is already included in the income, is taxable in this case.

However, the Finance Act, 2011 amended section 80CCE so as to provide that the contribution made by the Central Government or any other employer to the pension scheme under section 80CCD shall be excluded from the limit of one lakh rupees provided under section 80CCE. This proposal is effective from the assessment year 2012-13 (financial year 2011-12) and would totally exempt employer's contribution in NPS from levying income tax on the employee.

Income tax concession to Employers under NPS:

The Finance Act, 2011 amended section 36 so as to provide that any sum paid by the assessee as an employer by way of contribution towards a pension National Pension System (NPS) to the extent it does not exceed ten per cent of the salary of the employee, shall be allowed as deduction in computing the income under the head "Profits and gains of business or profession".

PERFORMANCE ANALYSIS OF TIER 1 NPS SCHEMES

There are 3 pension funds assigned to manage the contributions towards NPS from employees of Central and State Governments. They are SBI Pension Funds Private Limited, UTI Retirement Solutions Limited and LIC Pension Fund Limited. For Central Government employees mandatorily covered under NPS, the total contribution uploaded in an employee's Tier I account is divided among three PFMs. in a predefined ratio and units are allotted in the subscribers account. For State Government employees mandatorily covered under NPS, the total contribution uploaded in an employee's Tier I account is divided among the three PFMs. in a ratio as decided by the State Government and units are allotted in the subscribers account accordingly. The PFMs invest the money in different financial instruments within the investment guidelines laid down by PFRDA and declare Net Asset Value (NAV) at the end of each business day. The mandatory contributions are managed under the Tier 1 option in which the employee has no say deciding the asset allocation. As per the current guidelines each of the PFMs will invest the Tier 1 funds in the proportion of 85% in fixed income instruments and 15% in equity and equity related instruments. From year 2008 Central Government has entrusted the 3 PFMs to manage the pension contributions of its employees. About 24 State Governments have also followed it since then.

As on 7th October, 2012 a total of 10, 37,017 employees of the Central Government are already a part of NPS. The total corpus being managed under the NPS is Rs.21, 951 crores. The status of NPS in details is as under

S. No.	Employer / Sector	Number of Subscribers	Corpus under NPS (in Crore)
1.	Central Government	10,37,017	14,303
2.	State Government	14,21,281	6,702
3.	Private Sector	1,51,783	618
4.	NPS – Lite	12,54,860	328
Total		**38,64,941**	**21,951**

Central Government Employees Schemes

The table below shows the average return and standard deviation for each of the scheme for central government employees.

Central Government Employees' Schemes			
	SBI	LIC	UTI
Average Return	8.80%	8.93%	8.33%
Standard Deviation	5.96%	5.17%	4.94%

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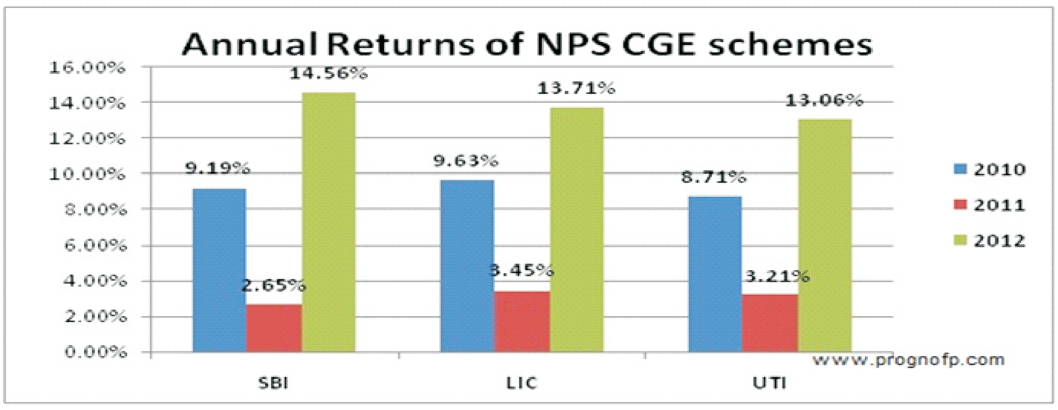
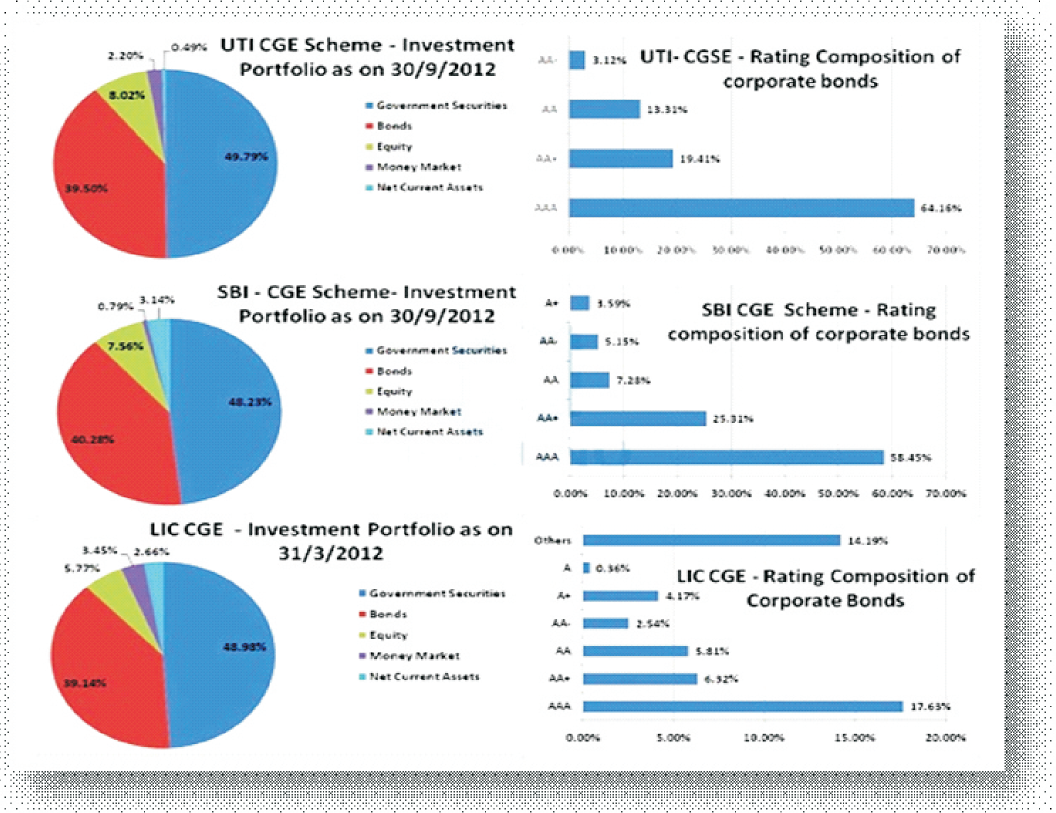
The returns were volatile from year to year. Considering the average returns the risk seems to be very high. A risk of 5.96% means that the returns for a year can go up or down by 5.96% from the average return during 65% of the time. 1 year bank fixed deposit of SBI gave interest between 6% and 9.25% during the 3 years under consideration. While the last 2 year compounded annual returns were 8.8%, 8.81% and 7.55% for SBI, LIC and UTI respectively the category average returns from Long Term Gilt Funds for the same period was 9.15%.

The annual returns of central government employees' NPS schemes managed by the 3 PFMs are as given below:



For year 2011 the returns for central government employees' schemes were very low between 2.65% given SBI and 3.45% given by UTI.
During 2011, the returns from top long term gilt funds meant for PF investments gave better returns. Birla Sun Life Gilt Plus – PF plan gave returns of 9.82%, IDFC G-Sec – PF plan gave returns of 9.59% and Kotak Gilt Investment gave 7.04% returns in calendar year 2011.

We have analyzed the latest released investment portfolios of the 3 PFMs. While UTI and SBI published the portfolios as on 30/9/2012, LIC has last published on 31/3/2012 only



While the proportion of investment in government securities is almost same for all PFMs the equity allocation is highest for UTI and lowest for LIC. This means that return potential for LIC fund is lower comparatively.

While UTI has invested 64.16% of investments in bonds in AAA rated securities, SBI it was 58.45% and LIC it was 17.63%. This means that LIC fund has taken higher risk by investing more on lower rated bonds.

State Government Employees Schemes

The table below shows the average return and standard deviation for each of the scheme for state government employees.

State Government Employees' Schemes			
	SBI	LIC	UTI
Average Return	9.90%	9.96%	9.69%
Standard Deviation	6.09%	5.66%	5.36%

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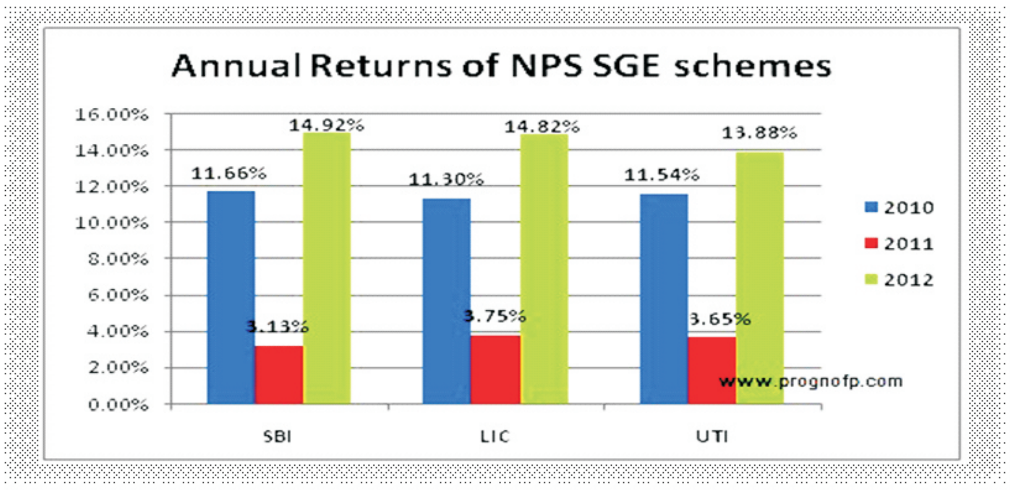
The returns were volatile from year to year. Considering the average returns the risk seems to be very high. Standard deviation of 6.09% means the returns can vary up or down by 6.09% from the average of 9.9% in a year during 65% of the time.

PPF which gives 8.6% tax free interest gives better tax adjusted return compared to these pension funds.

The annual returns of state government employees' NPS schemes managed by the 3 PFMs are as given below:



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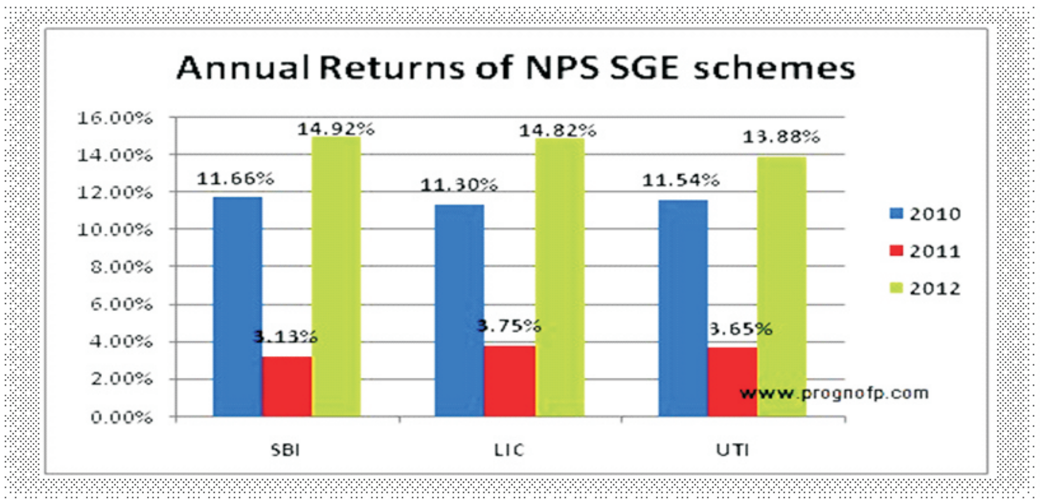
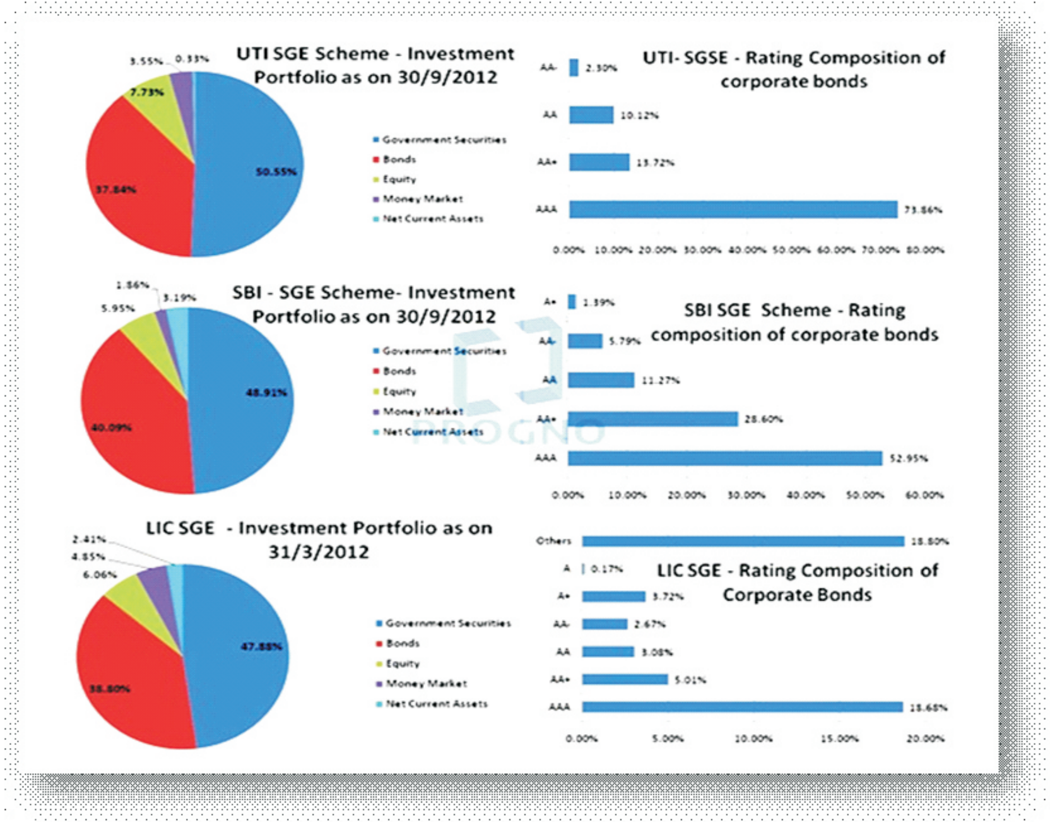


The returns of state government employees' schemes were higher that central government employees' schemes across all PFMs and all years.
For year 2011 the returns for state government employees' schemes were very low between 3.13% given SBI and 3.75% given by UTI.
During 2011, the returns from top long term gilt funds meant for PF investments gave better returns. Birla Sun Life Gilt Plus – PF plan gave returns of 9.82%, IDFC G-Sec – PF plan gave returns of 9.59% and Kotak Gilt Investment gave 7.04% returns in calendar year 2011.

We have analyzed the latest released investment portfolios of the 3 PFMs. While UTI and SBI published the portfolios as on 30/9/2012, LIC has last published on 31/3/2012 only.



While the proportion of investment in government securities is almost same for all PFMs the equity allocation is highest for UTI and lowest for LIC. This means that return potential for LIC fund is lower comparatively.

While UTI has invested 73.86% of investments in bonds in AAA rated securities, SBI it was 52.95% and LIC it was 18.68%. This means that LIC fund has taken higher risk by investing more on lower rated bonds.

CONCLUSION

The average returns were more or less equal to the debt market returns. But the returns were highly volatile. PPF which gives 8.6% tax free interest gives better tax adjusted return compared to these pension funds. The quality of corporate bonds in terms of credit rating was poor for LIC managed schemes. The investments in government securities were not more than 50% in most of the schemes. The fund managers were not keen in publishing the portfolios or NAV data in time. There is no standard format for the fact sheets published by different PFMs.

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