SECURING OUR FUTURE

ANALYSING THE REGULATORY FRAMEWORK FOR PENSIONS IN INDIA

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I. INTRODUCTION

In the post-World-War II world, for the first time, the world was faced with a large chunk of the population which could no longer work for a living. This fact compounded with increasing life expectancies, and a drastically changing social milieu meant that this part of the population was left outside the formal financial net. This, in turn, led to more visibility and attention from governments across the world on building strong, resilient, sustainable and scalable pension systems.

The last few decades have seen a rapid explosion in population and life expectancies, with developing and under-developed countries bearing the brunt of these twin problems. A number of other social changes, such as the increasing breakdown of traditional family structures and support systems, rapid industrialization, entry of women into the formal workforce etc. have accelerated the need for adequate regulatory attention to pensions. Further, because pensions are a long-term financial product, and yield almost no immediate, tangible benefits, they are a difficult product to sell, especially to low-income households, for whom "*saving for the future*" is often the last item on the laundry list of spending. The elderly, especially from lower income groups, are particularly vulnerable. Therefore, this is an area where regulatory reform must be accompanied by sound consumer safety mechanisms, and specific education initiatives.

In the context of India, the young population (median age) is touted as one of her biggest assets. It is a fact that very soon, India will have a large elderly population. According to a Government of India report[1], the elderly formed approximately 8.6 per cent of the population in India in 2011. Further, the elderly population is expected to grow at high rates in the coming years, reaching 19% of the total population by 2050[2], necessitating the presence of a comprehensive pension system to cater to their financial needs. Additionally, life expectancies have risen and simultaneously, there has been a breakdown of some traditional structures like the "*joint family system*" which the elderly could earlier lean on for support in their old age. The financing of health expenses and consumption post retirement is additionally expected to leave the elderly and their dependents particularly vulnerable to adverse shocks. According to a recent Reserve Bank of India (RBI) Report[3], 44% of this population does not expect to retire, 33% has no planning for retirement, 13% is actively saving for retirement and 10% is planning to save for retirement. The same Report pointed out that a very small part of this cohort is adequately covered through private pension plans, and that a large part of the population does not actively take steps to ensure adequate financial coverage post retirement.

Though a semblance of a pension system has been in existence in India since the 1950s, pensions have only recently come under the regulatory ambit in India, pursuant to the setting up of the Pension Fund Regulatory and Development Authority of India (PFRDA) in 2003. The PFRDA is responsible for establishing, developing and regulating pension funds in India. The PFRDA arose out of the report of the Old Age Social and Income Security Project (OASIS) Committee which set up with the twin aims of further improving existing pension provisions and devising a fresh pension plan for excluded

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[1] '*Elderly in India 2016*', Government of India, Ministry of Statistics and Programme Implementation (February 2016) available at: http://mospi.nic.in/sites/default/files/publication_reports/ElderlyinIndia_2016.pdf (last accessed on January 24, 2018), page iii.

[2] '*Caring for Our Elders: Early Responses India Ageing Report - 2017*', United Nations Population Fund New Delhi, (2017), available at: http://india.unfpa.org/sites/default/files/pub-pdf/India%20Ageing%20Report%20-%202017%20%28Final%20Version%29.pdf (last accessed on January 24, 2018), page 5.

[3] '*Indian Household Finance*', Report of the Household Finance Committee (July 2017), available at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/HFCRA28D0415E2144A009112DD314ECF5C07.PDF (last accessed on 24 January 2018), page 43.

workers, came out with its report in January 2000.[4] Based on its recommendations, in a significant move in December 2003, the Interim PFRDA was created as the watchdog and promoter for the pensions sector. Simultaneously, all government employees (with the sole exception of the armed forces) joining service on or after January 1, 2004, were compulsorily brought under the coverage of the New Pension System (NPS)[5] which was a defined contribution pension scheme replacing the defined benefit scheme available to Government employees until then. NPS was introduced for all citizens from May 2009. The broad structure of the NPS involved three agencies – Point of Purchase (POP), Central Record-keeping Agency (CRA) and Pension Fund Managers (PFMs).

In a country which is as socially, culturally, and economically diverse as India, and is replete with a number of socio-economic inequities, it is inevitable that there is no one-size-fits-all formula. The elder population itself is a very heterogeneous group, and there are smaller sub-sets within the larger group which are not only particularly vulnerable, but also have distinct features of their own. One such example is the unorganised sector in India, which employs an overwhelming majority of the Indian workforce.[6] While the output of the unorganised sector is not formally included in GDP calculations, the National Commission for Enterprises in the Unorganised Sector (NCEUS) in 2008 estimated that [7] this sector contributes almost half to the national GDP. Even by present estimates, the figure remains close to 50%[8]. Additionally, a vast majority of this cohort lives below the poverty line. While there are a number of state and national level social security schemes in existence in India supplementing their meagre income, there is only one formal pension system under the PFRDA's ambit, catering exclusively to this group, the Atal Pension Yojana (APY).

The combined figures of a rapidly burgeoning elderly population, and the lack of retirement savings do not bode well for the financial security of this cohort. The burden of their financial security is also likely to be passed on to the next generation, further exacerbating the inter-generational continuity of financial debt and uncertainty. Therefore, considering the criticality of the formal pensions framework in India, this paper has undertaken a study of the Pension Fund Regulatory and Development Authority Act, 2013 and some of the key regulations thereunder. It identifies some gaps in the legal and regulatory framework dealing with pensions in India and recommends suggestions to address these. Additionally, as mentioned above, the APY is a specialized scheme of the PFRDA applicable to the unorganized sector in India. It was felt that some of the legal and regulatory gaps identified in this report are particularly relevant for the APY, given its distinct features (which have been discussed in greater detail later in this report). To this end, this paper has pointed out some problem areas in the APY, and suggested specific legal and regulatory reforms for the same.

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[4] '*The Project OASIS Report*', The Project OASIS Committee (January 2001), available at: http://pfrda.org.in/WriteReadData/Links/Rep2d5d02004-a7c9-4875-be6e-f8b92744e210.pdf (last accessed on 25 January 2018).

[5] New Pension Scheme Notification F. No. 5/7/2003-ECB & PR, Government of India, Ministry of Finance (22 December 2003), available at: http://www.prsindia.org/uploads/media/PFRDA/bill74_2006123074_NEW_PENSION_SCHEME_NOTIFICATION.pdf (last accessed on 25 January 2018).

[6] '*ILO Labour Market Update*', International Labour Organiztion (July 2017), available at: http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/---sro-new_delhi/documents/publication/wcms_568701.pdf (last accessed on 25 January 2018).

[7] '*Contribution of the Unorganised sector to GDP Report of the Sub Committee of a NCEUS Task Force*' (National Commission for Enterprises in the Unorganised Sector), (June 2008), available at: https://ruralindiaonline.org/resources/contribution-of-the-unorganised-sector-to-gdp/ (last accessed on 25 April 2018).

[8] '*Actual GDP 0-1% if unorganized sector taken into account: Economist*', The Times of India (7 November 2017) available at: https://timesofindia.indiatimes.com/business/india-business/actual-gdp-0-1-if-unorganized-sector-taken-into-account-economist/articleshow/61550822.cms: (last accessed on 25 April 2018).

Accordingly, the present Report has been divided into five main chapters.

CHAPTER I (this chapter) provides an introduction, and a brief history and overview of pension schemes in India.

CHAPTER II specifies the regulatory challenges, and the potential areas for reform in the PFRDA Act, 2013 and its various regulations, while raising questions concerning the regulation of micro-pensions and the resolution of distressed pension funds.

CHAPTER III provides an overview of international best practices in the field

CHAPTER IV contains a case study of the APY and points out possible areas of legal and regulatory reform in the scheme.

CHAPTER V sums up the Report and serves as the conclusion.

II. THE PENSIONS FRAMEWORK IN INDIA: REGULATORY CHALLENGES

A. Overview

The Pension Fund Regulatory and Development Authority (PFRDA) Act, 2013 (PFRDA Act) provides the statutory basis for the pensions regime in India. The PFRDA, which is set up under the said Act, regulates the pensions sector, being in charge of the '*regulation, promotion and orderly growth of the National Pension System and other pension schemes*,'[9] as well as protecting subscriber interests.[10] However, the PFRDA has existed prior to the PFRDA Act, with the interim PFRDA being set up as way back as 2003.[11]

The PFRDA's primary responsibilities under the PFRDA Act include regulating the NPS, laying down investment guidelines, registering intermediaries, protecting subscriber interests and regulating regulated assets.[12] The PFRDA Act also contains the statutory regime for the NPS, providing for, amongst others - portable individual pension accounts, multiple pension funds and schemes, conditional exits, and mandatory annuitization at the time of exit.[13] The PFRDA is empowered to frame regulations to carry out its mandate under the PFRDA Act.[14]

B. The PFRDA Act, 2013

The bulk of the reforms suggested in this section would need to be effected by way of amendments to the Regulations under the PFRDA Act, or through the incorporation of new provisions. In this regard, we suggest the following changes in the Act.

1. **Section 4**: The provision does not contain a specific requirement to include members with expertise in the area of pensions. Due to the unique nature of pensions as a product and the explicit need to build expertise in this area, this needs to be provided for specifically in the Act.

2. **Section 16:** This section still reflects the old Companies Act, 1956, and has to be updated to the relevant sections of the new Companies Act 2013. Subsequently, the reference to "sections 235 to 241 of the Companies Act, 1956" needs to be amended suitably to "sections 210, 213, 214, 215, 217, 219, 220 and 223 of the Companies Act, 2013".

3. **Section 24:** This section specifies that the aggregate foreign shareholding in a pension fund shall not exceed twenty-six percent of its paid-up capital or the percentage as may be approved for an Indian insurance company under the Insurance Act, 1938, whichever is higher.[15] While the Insurance Act has been amended to reflect that the aggregate foreign

[9] The Pension Fund Regulatory and Development Authority Act 2013, § 14 (1). (*Hereinafter* 'PFRDA Act 2013')
[10] Ibid.
[11] The Interim Pension Fund Regulatory and Development Authority set up by the Central Government through Resolutions No. F. No. 5/7/2003-ECB&PR, dated the 10th October, 2003 and F. No. 1(6)/2007-PR, dated the 14th November, 2008.
[12] PFRDA Act 2013, § 14 (2).
[13] PFRDA Act 2013, § 20 (2).
[14] PFRDA Act 2013, § 52.
[15] PFRDA Act 2013, § 24.

shareholding in an Indian insurance company is capped at forty nine percent,[16] no such guideline has been provided for the pensions sector yet. The Government announced in 2015 that the foreign direct investment (FDI) limit in pensions would be brought in line with the limits prescribed for the insurance sector. Despite announcements to that effect, the Government has so far not issued any such guidelines[17]. This gives rise to avoidable confusion, especially since applicable foreign exchange regulations not only specify that foreign investment for the pensions sector is capped at 49%, but also that this must be in consonance with Section 24 of the PFRDA Act itself.[18] Therefore, amending Section 24 to state clearly the limit for foreign investment in pension funds would provide much needed clarity.

C. Regulations framed under the PFRDA Act, 2013

The PFRDA derives the power to make regulations from Section 52 of the PFRDA Act. The following part attempts to set out a brief analysis of the key regulations issued by the PFRDA, along with a brief summary of potential issues in such regulations.

1. The PFRDA (Redressal of Subscriber Grievance) Regulations, 2015[19]

The PFRDA (Redressal of Subscriber Grievance) Regulations, 2015 (Redressal Regulations) aim to provide a "*timely and seamless framework for handling grievances in the interests of the subscribers, by the intermediaries under the National Pension System and other pension scheme and for effective resolution of such grievances*"[20]. Given the importance of consumer protection, this area demands high attention on the part of regulators, and law-makers.

Under these Regulations, all intermediaries and pension schemes are required to follow the grievance redressal mechanism laid down, as well as file a grievance redressal policy. There are specified resolution times for grievances, as well as a mechanism of escalation to the NPS Trust, and consequently appeal to an Ombudsman.

Potential issues:

Disparate Structure:

The PFRDA is tasked with the duty to provide effective mechanisms of redressal of grievances of subscribers under section 14 of the PFRDA Act. Further, the Redressal Regulations[21] state that the Trust can *firstly* lay down detailed guidelines and procedures for a two-level grievance redressal policy for intermediaries and other entities with minimum conditions as referred to in regulation 4 and *secondly* shall be responsible for the overall grievance management system. It also states that any other pension scheme regulated by the Authority has to provide for a two-level grievance redressal policy approved by its board or decision making body, and all such grievance redressal policies for the NPS and for other pension schemes regulated by the Authority will have to be filed with the Authority or the Trust as the case may be, by the intermediary or

[16] The Insurance Laws (Amendment) Act, 2015, § 3(iv).
[17] '*Government planning to relax FDI rules for pensions sector*', The Economic Times (10 March 2018) available at : https://economictimes.indiatimes.com/news/economy/policy/government-planning-to-relax-fdi-rules-for-pensions-sector/articleshow/63242849.cms (last accessed on 21 April 2018).
[18] *See*, the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017, F9.
[19] The Pension Fund Regulatory and Development Authority (Redressal of Subscriber Grievance) Regulations, 2015, available at : www.pfrda.org.in//MyAuth/Admin/showimg.cshtml?ID=665. (*Hereinafter* 'Redressal Regulations').
[20] Redressal Regulations, Regulation 1.
[21] Redressal Regulations, Regulation 3.

entity or person governed by the provisions of the Act and placed prominently in public domain. This points to the dispersed nature of grievance redressal under the scheme of the Regulations.

No specific grounds for approaching the Ombudsman:

The Redressal Regulations provide for the escalation of the grievance from the intermediary to the NPS Trust at the first instance, and then from the Trust to the Ombudsman at the second instance.[22] Any appeal against an order passed by a designated member of the Authority lies with the Securities Appellate Tribunal, as provided in section 36 of the Act.[23] Strangely, there seems to be no specified grounds stipulated under the Redressal Regulations for approaching the office of the Ombudsman. This point features prominently in the Ombudsman schemes of other financial sector regulators such as the RBI's Banking Ombudsman Scheme and Securities and Exchange Board of India (SEBI)'s Ombudsman Regulations.[24] Its absence from the Redressal Regulations points to an oversight.

Need for an effective Ombudsman:

The United Kingdom presents an excellent example of how an effective redressal mechanism can vastly improve the confidence of subscribers in the financial system[25]. While India does not follow the approach of a sector agnostic consumer redressal mechanism, it is still worthwhile to examine some of the features of the UK[26] system: notably the informal manner of operation (complaints can be accepted through phone calls, and there are no formal and rigid procedures to be followed), which go a long way in making the system much more accessible. The UK financial redressal system is also hailed for its friendly processes and ability to communicate effectively in more than 40 languages apart from English.[27]

The Australian system in turn, provides a particularly relevant example of an approach where cases involving "financial difficulty" follow a tailored, engaged process[28]. Even in India, the importance of an independent specialized ombudsman is being increasingly recognized. SEBI has emphasised the need for "*a system of Ombudsman which should, as far as possible, be speedy, cheaper, efficacious, simple easily accessible, informal and amenable to the investors generally spread over the country.*[29]"

Lack of clarity with regard to the online grievance redressal portal:

It should be noted that National Securities Depositories Limited (NSDL) e-Governance Infrastructure Limited, which is the CRA appointed by the PFRDA under the NPS architecture, operates an online grievance portal for all NPS subscribers.[30] This portal enables subscribers to lodge their grievances, as well as track their progress. However, it is not clear whether the portal allows subscribers to escalate grievances to the Trust or the Ombudsman if they are dissatisfied

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[22] Redressal Regulations, Regulation 10.
[23] Redressal Regulations, Regulation 33.
[24] *See*, The Banking Ombudsman Scheme 2006, Reserve Bank of India, Chapter IV; The Securities and Exchange Board of India (Ombudsman) Regulations, 2003, Chapter IV.
[25] '*Report of the Task Force on Financial Redress Agency*', Government of India, available at: https://dea.gov.in/sites/default/files/Report_TaskForce_FRA_26122016.pdf (last accessed on 26 April,2018).
[26] The UK Financial Ombudsman portal is available at: http://www.financial-ombudsman.org.uk/, (last accessed on 26 April 2018). Also see Ibid n25.
[27] Ibid n25.
[28] The Australia Financial Ombudsman portal is available at: https://www.fos.org.au/, (last accessed on 26 April 2018) Also see Ibid n25.
[29] '*A Concept Paper on Ombudsman for the Securities Market*', Securities and Exchange Board of India (May 2003) available at : https://www.sebi.gov.in/sebi_data/attachdocs/1293102862086.pdf (last accessed on 25 April 2018).
[30] The portal is available at: https://npscra.nsdl.co.in/Log-your-grievance.php (last accessed on 25 January 2018).

with the resolution. Moreover, the portal seems to be only available in English, and not in any vernacular language, which in itself poses concerns surrounding accessibility of the subscriber base.

This system of consumer redressal is characterised by a lack of clarity and simplicity, which has the likelihood of decreasing consumer confidence, ultimately negatively affecting the efficacy of the entire NPS system. Consumer protection is becoming an increasingly important component of financial systems and emerging jurisprudence points to the adoption of a "*rights based approach*" in this regard. This is better explained by Sane and Thomas in their paper when they state that, "*The PFRDA needs to look to the Indian Financial Code as a benchmark to provide for various protections against misleading conduct by sales agents.*"[31] To provide some context, Part VII of the Indian Financial Code (IFC)[32], which specifies various provisions relating to 'Financial Consumer Protection', provides for, amongst other things, principles of consumer protection to be followed by financial service providers and regulators, protection of consumers- including dealing with unfair conduct, requirement of disclosure-both initial, and continuing, protection of personal information, suitability of the advice given, and financial awareness. Many of these, having sight of the level of dependence of the consumer on the financial product, are absent from the narrative of these Regulations.[33]

2. The PFRDA (National Pension System Trust) Regulations, 2015[34]

The aim of these Regulations is to "*lay down procedures for the appointment of Trustees to the NPS Trust, as well as to define their roles, responsibilities etc. in relation to the affairs of the Trust, for the protection of subscribers*"[35]. The Trust is governed by the Board of Trustees who have the legal ownership of the trust and the funds. The Trust is charged with the responsibility of all assets and funds under the NPS system. The Trust also has general powers of oversight over and co-ordination amongst all the intermediaries in the NPS framework. Additionally, it is responsible for redressal of subscriber grievances and in relations to exits and withdrawals from the NPS system.

Potential issues:

Unclear delineation of roles:

The Trust is regulated by PFRDA through the PFRDA (NPS Trust) Regulations, 2015.[36] The PFRDA appoints the Chairman, Trustees and the CEO of the Trust[37] However, in matters of general superintendence, direction, and management of the affairs of the Trust and all powers, authorities and discretions are vested in the Board of Trustees.[38] The Board of Trustees of the Trust is required to oversee the various audit reports, compliance reports of the PFM besides monitoring the performance of PFMs.[39] In terms of the Trust Deed dated 27th February 2008, the

[31] .'*The way forward for India's National Pension System*', Renuka Sane and Susan Thomas, WP-2014-022, Indira Gandhi Institute of Development Research, Mumbai (July 2014) available at http://www.igidr.ac.in/pdf/publication/WP-2014-022.pdf (last accessed on 25 January 2018).

[32]The Indian Financial Code (2014 Draft), available at: http://www.prsindia.org/uploads/media/draft/Draft-%20Indian%20Financial%20Code,%202015.pdf (last accessed on 25 January 2018). (*Hereinafter* 'IFC')

[33] IFC, Clause 107 (c).

[34] The Pension Fund Regulatory and Development Authority (National Pension System Trust) Regulations, 2015, available at: http://www.pfrda.org.in//MyAuth/Admin/showimg.cshtml?ID=709 (last accessed on 26 April 2018). (*Hereinafter* 'NPS Trust Regulations')

[35]NPS Trust Regulations, Regulation 1.

[36] NPS Trust Regulations.

[37] NPS Trust Regulations, Regulation 10.

[38] NPS Trust Regulations, Regulation 11(1).

[39] NPS Trust Regulations, Regulations 11 and 12.

Board of Trustees constitutes committee(s), with the Board of Trustees currently having constituted an Audit Committee to assist the Board in audit matters related to the Scheme Accounts of NPS.[40]

Thus, the Trust implements PFRDA Regulations, supervises and monitors the pension fund managers, and intermediaries, but the ultimate regulator remains the PFRDA. As section 2(j) of the PFRDA Act states, the Trust holds "*the assets of subscribers for their benefit*." Under section 52 (2)(v) of the PFRDA Act, the regulator has the power to make regulations for the establishment, duties and functioning of the National Pension System Trust. The Trust, under the architecture of the NPS, is an intermediary exercising critical functions and holding subscriber fund and assets in its custody. The Trust, therefore, enjoys significant powers. Given that the Trust is itself an intermediary under the overall supervision of the PFRDA, there is a need for clear delineation of powers between the Trust, and the PFRDA as the pensions regulator. A case in point is the seemingly overlapping and concurrent powers of the Trust and the Authority itself concerning inspections of intermediaries such as Custodian of Securities and Pension Funds under the respective Regulations[41]. Moreover, there is a general lack of clarity over the distinction between the regulator and the supervisor, leading to a potential conflict of interest. This of course has larger implications for the accountability of an agency for the general governance and management of the fund. The distinction between operational supervision, and legal regulation is one that is difficult to establish and creates multiple layers in the effective management of the fund itself. The 'Report of the Committee to Review Investment Guidelines for NPS Schemes in the Private Sector, 2015' stated that "*Although PFRDA is in the unique position of being the promoter, developer as well as Regulator of NPS, there has to be a candid separation between the Regulatory role and operational role of the Regulator*."[42]

Therefore, a clearer delineation of the roles and responsibilities of the Trust and the Authority is critical to ensure smooth functioning of the NPS itself. Ideally, a clear delineation in the two roles is better, both for prudential regulation, and accountability.

3. The PFRDA (Exits and Withdrawals under the National Pension System) Regulations, 2015[43]

The PFRDA (Exits and Withdrawals under the National Pension System) Regulations, 2015 ('Exit Regulations') detail the mechanism for withdrawals from individual pension accounts in the NPS regime, and set out conditions for exiting the NPS, including mandatory purchase of annuities at the time of exit.

The Exit Regulations categorize NPS subscribers as belonging to the Government sector, all citizens including the corporate sector, and NPS-Lite/Swavalamban subscribers. While there are differences in the specifics of the processes for each of the three groups, the broad framework is as follows:

- On the subscriber reaching a certain age/superannuation, there is a proportion of the accumulated corpus which must be mandatorily annuitised (the proportion is higher in case the exit precedes the specified age);

[40] '*Governance*', The NPS Trust, available at: http://www.npstrust.org.in/content/governance (last accessed on 26 April 2018).

[41] The Pension Fund Regulatory and Development Authority (Custodian of Securities) Regulations, 2015; The Pension Fund Regulatory and Development Authority (Pension Fund) Regulations, 2015.

[42] '*Report of the Committee to Review Implementation of Informal Sector Pension*', The Pension Fund Regulatory and Development Authority of India (July 2011), available at: http://www.npstrust.org.in/sites/default/files/CRIISPReport_0.pdf (last accessed on 12 April 2018). (*Hereinafter* 'CRISIP Report')

[43]The PFRDA (Exits and Withdrawals under the National Pension System) Regulations, 2015 , available at: http://www.pfrda.org.in//MyAuth/Admin/showimg.cshtml?ID=706 (last accessed on 26 April 2018).(*Hereinafter* 'Exit Regulations')

- Further, there is a default annuity scheme (Annuity for life with a provision of 100% of the annuity payable to spouse during his/her life on death of annuitant) and Annuity Service Provider (LIC) applicable for all variants of NPS.[44]
- The remaining corpus may be withdrawn by the subscriber;
- In case the accumulated corpus is below a certain threshold, complete withdrawal is possible; and
- Withdrawal is permissible only in respect of a certain proportion of contribution.

Potential issues:

Likelihood of Regulatory Overlap:

Annuity Service Providers (ASPs) are essentially insurance companies registered with the Insurance Regulatory and Development Authority (IRDA) but empanelled with the PFRDA to provide annuities to subscribers under the NPS.[45] This is an area where potential regulatory overlap may exist between the insurance and the pensions regulator, particularly considering that the purpose of a purchase of a mandatory annuity under the NPS is to presumably provide a regular income post-retirement. Further, ASPs handle consumer grievances in respect of annuities under the NPS in accordance with grievance redressal procedures of the IRDA.[46] Moreover, complaints are to be settled in terms of the IRDA Act in terms of regulations for 'insurers'[47]. As such, the Code of Conduct to be followed by ASPs are as issued by the IRDA.[48] This again seems to be an area where regulatory overlap may exist, particularly considering that there is a dedicated grievance redressal mechanism under the pensions framework. Although the PFRDA is empowered to consult with the IRDA in order to remove any difficulties in the annuity purchase, grievances arising out of annuity purchase or any other matter associated with annuity purchase by subscribers,[49] a clearer delineation of the treatment of ASPs would prove useful.

Lack of clarity in cases of default:

There is not enough clarity on how cases of default and inspections of ASPs are to be handled, considering that the regulatory authority for ASPs is the IRDA, even in respect of functions which are discharged under the NPS. This again is an area where further clarity may be considered to avoid regulatory overlap between the insurance and the pensions regulators.

4. The PFRDA (Aggregator) Regulations, 2015[50]

The Aggregator Regulations essentially provide the regulatory framework for the registration of Aggregators and monitoring of the implementation of National Pension System for the best interest of the target subscribers.[51]' In the context of the Swavalamban scheme, an aggregator is defined as being an intermediary who performs subscriber interface functions under the National Pension System-Swavalamban model.[52] Aggregators are provided fixed incentives based

[44] '*Default ASP and Annuity Scheme for subscribers exiting from NPS and Seeking withdrawal of Accumulated Pension Wealth*' PFRDA Circular PFRDA/2013/5/PDEX/4 (14 February 2013) available at: https://npscra.nsdl.co.in/download/Default%20ASP%20and%20Annuity%20Variant.pdf (last accessed on 25 January 2018).
[45] Exit Regulations, 2015, Regulation 2(d).
[46] Exit Regulations, 2015, Regulation 22(5).
[47] Exit Regulations, 2015, Regulation 22(6).
[48] Exit Regulations, 2015, Regulation 25.
[49] Exit Regulations, 2015, Regulation 26.
[50] The Pension Fund Regulatory and Development Authority (Aggregator) Regulations, 2015, available at: http://www.pfrda.org.in//MyAuth/Admin/showimg.cshtml?ID=692 (last accessed on 26 April 2018). (*Hereinafter* 'Aggregator Regulations')
[51] Aggregator Regulations, 2015.
[52] Aggregator Regulations, 2015, Regulation 2(1)(b).

on each individual subscriber who is eligible for Swavalamban. In the specific context of the Swavalamban scheme,[53] the PFRDA is mandated to prescribe pre-defined asset classes for investment and subscribers have the option to choose the investment mix and Pension Fund through the aggregator, with there being an option to change the Pension Fund. The responsibilities of aggregators, *inter alia*, include, creating awareness about the NPS, conducting KYC processes in respect of Swavalamban subscribers, ensuring availability of services to its underlying NPS-Swavalamban scheme subscribers as mandated under National Pension System-Swavalamban and handling and resolving subscriber grievances in accordance with PFRDA's Redressal Regulations, 2015.[54] Aggregators may further employ 'facilitators', with aggregators being responsible for the omissions and commissions of such facilitators.[55]

Potential issues

Absence of a clear code of conduct for facilitators:
While the Aggregator Regulations specify the Code of Conduct to be followed by Aggregators, there seems to be no such specific Code for facilitators who may be employed by Aggregators. This is an issue which is particularly critical, since these facilitators play an important role in last-mile inclusion and on-boarding of subscribers, especially under the NPS-Swavalamban model. It is imperative therefore, that clear standards of conduct be formulated and made applicable to such facilitators, instead of merely making aggregators responsible for the actions of such facilitators, as has been done in the Aggregator Regulations[56]. Further, while Regulation 16 gives welcome flexibility to decide the terms of engagement between the aggregator and facilitator for specifying the scope of its functions, responsibility and mutual liabilities arising out of NPS Swavalamban through a formal memorandum of understanding or contract, this flexibility should not lead to unintended consequences of a gap in governance. In order to balance this flexibility with protection of interests of subscribers, basic standards of governance, and duties and responsibilities in the context of facilitators should be provided in the regulations.

The absence of a clear code of conduct for the facilitators can have the effect of incorrect or inadequate information being conveyed to subscribers. This gets all the more amplified in a sector marked by high information asymmetries and commission-based model of compensation.

N: B: This must be read along with the next section on the Points of Presence Regulations.

5. The PFRDA (Point of Presence (PoP)) Regulations, 2015[57]

The aim of the Point of Presence Regulations (PoP Regulations) primarily is to "*ensure an independent, strong and effective distribution channel for National Pension System and ensuring that market practices of the points of presence are fair, efficient and transparent for the promotion and protection of interest of the subscribers*". PoPs are essentially intermediaries under the NPS framework, who are responsible for managing initial interaction with consumers, subscriber registrations, handling subscriber requests and generally providing services to subscribers.[58] PoPs are permitted to collect initial subscriber registration and contribution upload

[53] Aggregator Regulations, 2015, Regulation 15.
[54] Aggregator Regulations, 2015, Regulation 14.
[55] Aggregator Regulations, 2015, Regulation 16.
[56] Aggregator Regulations, 2015, Regulation 16.
[57] The PFRDA (Point of Presence) Regulations, 2015, available at: http://www.pfrda.org.in//MyAuth/Admin/showimg.cshtml?ID=658 (last accessed on 26 April 2018). (*Hereinafter* 'Point of Presence Regulations')
[58] Point of Presence Regulations, 2015, Regulation 14.

charges, in addition to collecting subsequent transaction charges from subscribers for their services.[59]

Potential issues

Remuneration of PoPs:

Because PoPs are critical to the spread and uptake of pension schemes like APY, adequately incentivizing them is of utmost importance and needs to be looked into. While the PFRDA has recently increased the commissions payable to them[60], to enhance the incentive structure further, an *ad valorem* scheme of commission can be looked into[61].

Multiple entities:

Further, the present system of multiple regulations for distribution related activities is likely to create not just duplication within the system, but a lack of clarity with regard to, eligibilities, compliance and registration requirements. To this end, the PFRDA is currently proposing to create a unified regulatory framework covering all intermediaries involved in the collection and transmission of the contributions by suitably amending the existing PFRDA (Point of Presence) Regulations, 2015 so as to cover POPs, aggregators and APY-Service Providers[62].

While the final outcome remains to be seen, some issues can be identified on the face of the draft regulations.

While Schedule II to the Draft Regulations does provide for a code of conduct, it lacks guidelines on critical concepts like "unfair advantage", "unfair conduct", "misleading", etc. Given that the document is not only supposed to act as guidance to the points of presence and aggregators, but also as a standard of care subscribers are entitled to, more details on this would be welcome. A clear standard of care for aggregators is also missing. These factors, while seemingly simple and basic, not only give the consumers higher degree of protection, but also make it easier to sell on part of the aggregators. An important point in today's age of big-data, the confidentiality requirements provided in the draft regulations seem to be cursory at best. Given the higher vulnerability of financial data, well defined and stringent obligations need to be incorporated in this regard.

For instance, schedule III (2) (a) and (b) lay down that:

(a) not collect personal information relating to a subscriber **in excess of what is required for the provision of a National Pension System**

(b) maintain the confidentiality of personal information relating to subscribers and not disclose it to a third party, **except where required under law.**

Both are quite vague and leave a lot of discretionary ground for the PoP, and in the absence of an overarching data protection law in the country, may end up being misused, and offer little protection against misuse.

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[59] Point of Presence Regulations, 2015, Regulation 15.

[60] *Pension fund regulator PFRDA hikes incentives for distributors to promote NPS*, Livemint, (28 October 2017) available at: https://www.livemint.com/Politics/FlGhlvhWkTDtbMiu88Qt2N/Pension-fund-regulator-PFRDA-hikes-incentives-for-distributo.html (last accessed on 10 April 2018).

[61] Ibid, n40.

[62] '*Exposure Draft on Proposed Amendment To Point Of Presence (Pop) Regulations, 2015 To Create A Unified Regulation Covering The Activities Of Point Of Presence (Pop), Aggregator And Atal Pension Yojana-Service Providers(APY-SPS)*', PFRDA (10 January 2018) available at: http://www.pfrda.org.in/MyAuth/Admin/showimg.cshtml?ID=1276 (last accessed on 25 January 2018).

It would be worthwhile to specifically lay down or at the very least, illustrate the type of information that may be permissibly collected under the NPS.
Most importantly, the Regulations nowhere specify penalties for the PoP if there is a breach of confidentiality. The Regulations require confidentiality, and Schedule III is composed of further stipulations in this regard. For the unorganised sector in particular, the subscriber's version of "informed consent" as per the regulations would have to be further tailored. Considering the criticality of the financial information which is likely to be collected under these Regulations, the treatment of confidential information upon a subscriber's death or exit from the scheme should also be provided for.

6. The PFRDA (Pension Fund) Regulations, 2015[63]

The stated objective of the PFRDA (Pensions Fund) Regulations is to "*standardize the framework for monitoring, supervision and internal control for Pension Funds to enable them to establish high standards for internal control and operational conduct, with the aim of protecting the subscribers and ensuring proper management of risk*"[64]. These Regulations essentially deal with the governing framework and functions of pension funds, which are tasked with managing and investing subscriber assets under the NPS framework. Amongst others, pension funds are mandated to follow the investment guidelines laid down by the PFRDA and can charge investment management fees for managing subscriber funds.[65]

Potential issues:

Regulations on management fees:
The investment policies have been called into question, including the regulations on management fees. For instance, a 2017 Report of the Household Finance Committee[66] has pointed out how these fees are very low in comparison to other jurisdictions and has recommended exploring the issue of raising this cap on the management fees.

Foreign investment limit in pension funds:
Additionally, the Pension Fund Regulations require amendment to reflect the current permissible limit for foreign investment in pension funds,[67] in consonance with the changes suggested to Section 24 of the PFRDA Act, which has been described earlier in this Report.

7. The PFRDA (Retirement Adviser (RA)) Regulations, 2016[68]

The objective of the PFRDA (Retirement Adviser (RA Regulations) is to "*provide a framework for eligibility, registration process, fees etc. of Retirement Advisers and to define the scope of work and responsibility of the Retirement Adviser to ensure orderly growth of pension sector*". Retirement Advisers are essentially intermediaries under the NPS architecture, who are

[63] The Pension Fund Regulatory and Development Authority (Pension Fund) Regulations, 2015, available at: http://www.pfrda.org.in//MyAuth/Admin/showimg.cshtml?ID=711 (last accessed on 26 April 2018). (Hereinafter 'Pension Fund Regulations')
[64] Pension Fund Regulations, 2015.
[65] Pension Fund Regulations, 2015, Regulations 14 and 20.
[66] Ibid n3.
[67] Pension Fund Regulations, 2015, Regulation 8 (1)(f).
[68] The Pension Fund Regulatory and Development Authority (Retirement Adviser) Regulations, 2016 available at: http://www.pfrda.org.in//MyAuth/Admin/showimg.cshtml?ID=897 (last accessed on 26 April 2018). (*Hereinafter 'Retirement Adviser Regulations'*)

responsible for providing subsequent advice to NPS subscribers.[69] Retirement Advisers are permitted to charge fees for retirement advice, on-boarding and subsequent services, which are subject to the maximum as determined by the PFRDA from time to time.[70]

Potential issues:

Advisory fees:
Certain financial advisors have critiqued the advisory fee of 0.02%[71] as being too low to act as sufficient incentive, and even the upper limit of Rs. 1,000 as not being remunerative enough[72]. Understandably, the regulator does not want to increase the fee, for fear of increasing the overall cost for the investors. However, the fee may be revisited to strike a balance between being competitive, without increasing costs.

8. Investment Guidelines for the NPS Trust

A PFRDA circular dated 3rd June, 2015[73] lists the investment guidelines for NPS Schemes, applicable to a number of schemes including the NPS Lite, and the APY, with effect from 10th June, 2015.[74] It lists the percentage amount to be invested in various kinds of investment. This includes up to 50% in Government securities and related investments, up to 45% in debt instruments and related investments, up to 5% in short term debt instruments and related investments, up to 15% in equities and related investments, up to 5% in asset backed, trust structured and miscellaneous investments. Guideline 11 imposes certain restrictions/filters for Government NPS schemes (including NPS Lite and APY) to reduce concentration risks in the NPS investment of the subscribers.
Broadly, the PFRDA regulations, Investment Guidelines along with the Investment Management Agreement with the Trust lay down the regulatory framework for managing the investment portfolio.

Potential Issues:
As pointed out by Sane and Thomas in their 2014 paper[75], "*The design also allowed for investments in international equity subject to regulatory oversight. The Expert Group set up by the PFRDA in 2009 further recommended that the maximum exposure allowed for equity be set to 100 percent (Parekh, 2009).*" They further add that "*Investment in international markets is not permitted under the current regulations. This reduces the ability of the fund manager to achieve lower risk through higher diversification by allowing international exposure.*" The 2015 'Report of the Committee to Review Investment Guidelines for National Pension System (NPS) in

[69] Retirement Adviser Regulations, 2016, Regulation 2(xi).
[70] Retirement Adviser Regulations, 2016, Regulation 15.
[71] 'Introduction of Advisory Fee under Regulation of PFRDA (Retirement Adviser) Regulations, 2016' PFRDA (22 September 2016) available at: https://www.npscra.nsdl.co.in/download/pdf/Circular-Advisory-Fee.pdf (last accessed on 25 January 2018)
[72] Ibid.
[73] '*Investment Guidelines for NPS Schemes*', Circular No. PFRDA/2015/16/PFM/7, Pension Fund Regulatory and Development Authority of India (3 June 2015) available at: http://www.npstrust.org.in/sites/default/files/InvGuidelines10Jun2015.pdf (last accessed on 25 January 2018).
[74] Ibid. However, the instructions supersede only part of the Investment Guidelines for NPS Schemes Applicable to Government Sector, Corporate CG and NPS Lite Schemes of NPS prescribed by PFRDA vide Circular No. PFRDA/2014/02/PFM/1 dated 29.01.2014. (Regulation 12).
[75] Ibid n31.

the Private Sector'[76] notes that "*An important reason for the existence of investment limits for NPS lite pension scheme is the information asymmetry between the various stakeholders—this is most obvious, for example, in the case between fund managers and subscribers to NPS Lite scheme for the unorganised sector*." The 2017 Survey of Investment Regulations of Pension Funds[77] reveal other restrictive practices, such as prohibition on direct investment in the real estate market.

It will be worthwhile to consider some of the 2015 Committee's deliberations on the way forward to create an enabling framework for a self-sustainable pension system with the twin objective of ensuring security, and adequacy of pension wealth.

D. Other challenges

1. The Absence of a Regulatory Framework for Micro-Pensions

Micro-pensions refer to long-term savings made by individuals employed in the informal sector at low wages, with a view to obtain income security in old age.[78] As Asher and Shankar emphasize, micro-pensions are critical in providing a regular source of income in old age.[79]

Micro-pension products, therefore, have as their main function, serving the retirement needs of a demographic which is in the most need of social security. As other parts of this Report discuss, this demographic is a vast majority of the workforce in the unorganized sector, in the Indian context, towards which schemes such as the APY are targeted. Therefore, understanding the manner in which micro-pensions are different from traditional pension products, and what this entails for the regulatory framework for micro-pensions is critical.

Micro-pension products differ from traditional pension products in that there are issues of proximity of pension fund managers to consumers, which tend to be exacerbated in the case of the former.[80] Secondly, customer awareness is lower for micro-pensions than traditional pension products. Third, micro-pension products tend to involve a larger number of transactions and transaction costs, while involving lower individual transaction value, as compared to traditional products. Additionally, micro-pensions involve larger distribution costs and issues of designing appropriate incentives.

Therefore, micro-pensions are an important part of the overall pension architecture and should form an integral part of the overall pensions framework. This implies that the creation of a sound regulatory framework dealing with micro-pensions is critical.

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[76] '*Report of the Committee to Review Investment Guidelines for National Pension System (NPS) Schemes in Private Sector*', Pension Fund Regulatory and Development Authority, New Delhi (2015) available at: http://www.npstrust.org.in/sites/default/files/showimg_1.pdf (last accessed on 25 January 2018).

[77] '*Annual Survey of Investment Regulation of Pension Funds*', OECD (2017), available at: https://www.oecd.org/daf/fin/private-pensions/2017-Survey-Investment-Regulation-Pension-Funds.pdf(last accessed on 25 January 2018).

[78] This definition is adapted from '*Micro-pensions in India: Issues and challenges*', Savita Shankar and Mukul G. Asher, International Social Security Review, Vol. 64, 2/2011, page 2. (Hereinafter '*Shankar and Asher*')

[79] Shankar and Asher.

[80] The characteristics are adapted from '*Micro-Pensions in India: Critical Issues, Challenges and Strategies for Future Study*', Ramesh S Arunachalam, available at: http://www.pensiondevelopment.org/documenten/Report%20MicroPensions%20India%20Ramesh%20Arunachalam.pdf (last accessed on 19 April 2018), paragraphs 13, 14 and 15. (*Hereinafter* 'Arunachalam')

As on date, there is no dedicated regulatory framework for micro-pensions in India, which points to a gap in the existing regulatory framework for pensions. It is also important to note here that there are unique challenges in the regulation of micro-pensions. For instance, as has been pointed out, micro-pensions in themselves are a long-term product, with significant sensitivity, given the vulnerability of the target audience.[81] Hence, it has been argued that pensions and micro-pensions require distinctive regulation.[82]

While the PFRDA has issued various regulations from time to time, (some of which find mention in this Report), there is no dedicated regulation dealing with the creation of an enabling framework for micro-pensions. This is unlike the case of micro-insurance, for instance, where the IRDA has issued a distinctive set of guidelines.[83] An additional concern which has been expressed is that the distinctive nature of micro-pensions may require PFRDA to co-ordinate with other financial sector regulators such as the IRDA and SEBI, as well as the Ministry of Finance to create an effective regulatory framework.[84] This implies that any meaningful attempt at creating a regulatory framework must necessarily involve cross-regulatory consultation and dialogue.

Another related aspect in a potential regulatory framework governing micro-pensions is the potential leveraging of existing micro-finance institution (MFI) networks to distribute micro-pensions. MFIs in India typically engage in the provision of micro-credit and hold considerable promise as a potential distribution channel for micro-pension products.[85] At present, there is no governing legislation for the regulation of MFIs[86], though the Micro Finance Institutions (Development and Regulation) Bill, 2012 (MFI Bill)[87] which has since lapsed, was an attempt at regulating the micro-finance sector. The shortcomings of the MFI Bill are well- documented. [88] However, what is notable is that the MFI Bill did envision encompassing 'pension services' within the ambit of 'micro-finance'.[89] The Bill at this stage is lapsed and therefore an analysis may not prove productive. Nonetheless, this points to the pressing requirement that any attempt at regulating MFIs in future, may have a direct impact on micro-pensions and its regulation.

To conclude, any serious attempt at creating an integrated regulatory framework for micro-pensions must necessarily be harmonized with the regulation of MFIs in general, and the PFRDA as the regulator for the pensions sector must take the lead in ensuring this. A failure to do so would only result in avoidable regulatory arbitrage.

2. The Resolution of Distressed Pension Funds

Another area of regulatory reform lies in the area of resolution. Simply put, the resolution of distressed financial institutions in India is scattered across various laws, sectoral regulators, and widely dispersed powers. For pension funds in particular, resolution becomes tricky, both on account of difficulty in identifying a particular institution with assets on its balance sheets that can be

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[81] Arunachalam, para 24.
[82] Arunachalam.
[83] The Insurance Regulatory and Development Authority of India (Micro Insurance) Regulations, 2015.
[84] This is also one of the suggestion of Arunachalam (at para 24).
[85] Shankar and Asher, pages 9 and 10.
[86] Only MFIs registered with the RBI as NBFCs are currently under the regulatory ambit of RBI.
[87]The Micro Finance Institutions (Development And Regulation) Bill, 2012 available at : http://www.prsindia.org/uploads/media/Micro%20Finance%20Institutions/Micro%20Finance%20Institutions%20%28Development%20and%20Regulation%29%20Bill,%202012.pdf (last accessed on 26 April 2018). (*Hereinafter* 'MFI Bill 2012')
[88] *See, 'Regulating Microfinance Institutions'*, Renuka Sane and Susan Thomas, Economic & Political Weekly, February 2, 2013, Volume XLVIII No 5, 59, pages 65 and 66.
[89] MFI Bill 2012, §1(j).

resolved effectively, and also the lack of clear guidance in this area. In India, given that the Insolvency and Bankruptcy Code, 2016 (IBC) and the proposed Financial Resolution and Deposit Insurance Bill, 2018 (FRDI Bill) both do not explicitly cover the resolution of distressed pension funds, the regulatory issues in this regard remain unresolved. This part of the Report attempts to explain this issue in more detail.

Pension funds and entities have typically been the repository of not just consumer funds, but also of public faith. Global experience, and particularly in the last decade has shown us the value of investing thought into the treatment of pension funds/entities, especially when they are distressed, or deteriorating in their health rapidly. The disorderly demise of pension funds/entities can lead to a loss of public confidence in both the Government (particularly when the Government is the pension provider, which is the case in India for a majority of the population, particularly the unorganised sector), and the financial system as a whole. Further, pension funds and entities have linkages with several other financial sector players, like banks (trustee banks which make the investment and handle the operational aspects of the fund), aggregators and distributors, and insurance companies (where there is some element of underwriting, or it is a hybrid product). However, most importantly, some pension funds/entities can grow so big, that they can achieve systemic importance, and may even be termed as a '*Systemically Important Financial Institution*' (SIFI).

As mentioned earlier, in the case of India, the treatment of distressed pension funds/entities are not explicitly covered either under the IBC or the proposed FRDI Bill. In this regard, it is also important to consider whether the pension scheme is a defined benefit scheme in nature, or one which is a defined contribution scheme. For instance, in a defined benefit arrangement, the sponsor-employer/state will be responsible for certain benefits determined under the scheme, with the employer/state (sponsor) bearing the risk that plan assets will not sufficiently fund the benefits. In a defined contribution arrangement, the sponsor contributions are fixed, and the subscriber's benefit is equal to the accumulated value of sponsor and subscriber contributions in the subscriber's account. In this, the subscriber is usually vested with the risk that accumulated assets will not provide adequate funds for retirement.

The section below refers to past committees and policy papers, both national and international, that shed some light in this regard.[90]

(a) Financial Sector Legislative Reforms Commission Report: Vol I, March, 2013[91]

The Report, in Chapter 2 on 'The tasks of financial law' states that "*The best efforts of micro-prudential regulation will reduce, but not eliminate, the failure of financial firms. When such episodes arise, a specialised resolution capability is required to ensure graceful winding up of a financial firm that has become unviable and transition the customers of the erstwhile firm. Under a formal arrangement such as this, a key difference that will be induced by a resolution corporation will be reduced burden on tax payer resources by failing financial firms. When a financial firm is healthy, it would face micro-prudential regulation, while the resolution corporation would lie in the background. When the firm approaches failure, it would increasingly face the resolution corporation. This requires the legal framework to create a resolution corporation and set it in motion.*"

[90] Please note that the authors have referenced parts of all cited Reports for greater clarity.
Further, important bits have been highlighted in bold.
[91] '*Report of the Financial Sector Legislative Reforms Commission*', Volume I, Government of India, (March 2013) available at: http://dea.gov.in/sites/default/files/fslrc_report_vol1_1.pdf (last accessed on 25 January 2018).

Chapter 7 of this report, on 'resolution' states that "*Drawing on international best practices, the Commission recommends a unified resolution corporation that will deal with an array of financial firms such as banks and insurance companies; it will not just be a bank deposit insurance corporation. The corporation will concern itself with all financial firms that make highly intense promises to consumers, such as banks, insurance companies,* ***defined benefit pension funds****, and payment systems. The corporation will also take responsibility for the graceful resolution of systemically important financial firms, even if they have no direct link to consumers.*"

(b) Report of the Working Group on Resolution Regime for Financial Institutions (Reserve Bank of India, January 2014)[92] and Report of the Bankruptcy Law Reforms Committee, (4th November 2015)[93]

The viewpoint of an independent and specialized resolution mechanism for financial firms was also shared in the above-mentioned reports. While the RBI Report recognised the difficulties in bringing all financial institutions within the scope of a single financial resolution framework, they considered the special nature of financial institutions, as well as limitations in applying corporate insolvency laws to these institutions; recommending a separate comprehensive legal framework for resolving financial institutions and FMIs.

(c) Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations: Background Paper Report to the G-20 Finance Ministers and Central Bank Governors[94]

This 2009 Guidance pertinently noted that "...***Insurance companies and pension funds are seen as the next most relevant in terms of their potential impact on financial/economic stability***." It also clarified that "*banks, insurance companies and pension funds continue to be perceived as key "systemic" institutions in many financial systems post-crisis.*"

(d) Financial System Stability Assessment of the US- IMF[95]

In the context of the United States, the World Bank-IMF Report stated that "*Pension funds may also give rise to systemic risks in the U.S. financial system. While many funds are shifting towards defined contribution, defined benefit plans still remain almost half of the industry, and about 20 percent of multi-employer pension funds are underfunded. Pressure to improve returns could spur undue risk taking, whether via direct credit exposure or through securities lending and cash reinvestment. As noted in the 2015 FSOC Annual Report, the transfer of pension risk to the insurance industry, through 'longevity swaps' and other insurance products, increases the interconnectedness of the system.*"

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[92] '*Report of the Working Group on Resolution Regime for Financial Institutions*', Reserve Bank of India (January 2014), available at: http://www.finmin.nic.in/sites/default/files/fsdc/Report%20of%20the%20Working%20Group%20on%20Resolution%20Regime%20for%20Financial%20Institutions%20%281%29_0.pdf (last accessed on 25 January 2018).

[93]'*Report of the Bankruptcy Law Reforms Committee*' Volume I, The Bankruptcy Law Reform Committee (December 2015), available at: http://ibbi.gov.in/BLRCReportVol1_04112015.pdf (last accessed on 25 January 2018).

[94]'*Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations— Background Paper Report to the G-20 Finance Ministers and Central Bank Governors*' Staff of the International Monetary Fund and the Bank for International Settlements, and the Secretariat of the Financial Stability Board (October 2009) available at: https://www.imf.org/external/np/g20/pdf/100109a.pdf (last accessed on 25 January 2018).

[95] '*United States Financial Sector Assessment Program*', International Monetary Fund (July 2015) available at: http://www.imf.org/external/pubs/ft/scr/2015/cr15170.pdf (last accessed on 25 January 2018).

(e) Response of the ESRB Response to the European Commission Consultation on a possible recovery and resolution framework for financial institutions other than banks[96]

The European Systemic Risk Board has also stated that certain kinds of pension funds may pose systemic risk and urge a serious review of their treatment in situations of financial distress. The Board has emphasized upon a detailed discussion on whether large defined benefit pension funds should be included in the scope of any recovery and resolution framework for financial institutions other than banks.

(f) FSB and IOSCO- Consultative Paper on Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities[97]

In September 2015, the FSB reviewed its work on asset management structural vulnerabilities and identified potential vulnerabilities of pension funds and sovereign wealth funds (SWFs) as an area for further analysis. While some vulnerabilities from a financial stability perspective were associated with defined benefit plans that faced significant challenges in the prolonged low interest rate environment, some challenges were associated with defined contribution plans that resembled those of investment funds. Largely, the Paper identified certain vulnerabilities particular to pension funds (both defined benefit, and defined contribution)- a potential for liquidity risk in some types of defined contribution pension funds, reach for yield and portfolio rebalancing risk, potential build-up of leverage, use of derivatives and longevity risks. They stressed upon the need for better management of counterparty risk, and interconnectedness in the financial system.

In conclusion, because of the importance of pensions as a financial product, and the possibility of its systemic importance in some cases, we urge a more nuanced discussion over whether pension funds and schemes ought to be dealt with either under the IBC, or the FRDI Bill.

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[96] '*Response to the European Commission Consultation on a possible recovery and resolution framework for financial institutions other than banks*', European Systemic Risk Board (19 December 2012) available at: https://www.esrb.europa.eu/pub/pdf/other/121220_ESRB_response.pdf?dba2cf98d238dc74e5e8c182804ab48c (last accessed on 25 January 2018).

[97] '*Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities*', Annex 2, Financial Stability Board (12 January 2017) available at: http://www.fsb.org/wp-content/uploads/FSB-Policy-Recommendations-on-Asset-Management-Structural-Vulnerabilities.pdf, (last accessed on 25 January 2018).

III. COMPARATIVE REGULATORY FRAMEWORKS FOR PENSIONS

This chapter lays out some best practices followed in some other jurisdictions of the world, and some settled principles of good pension designs and draws upon some key learnings.

1. New Zealand

The pensions framework in New Zealand comprises of the NZ Superannuation and the KiwiSaver, which taken together, form a simple structure for providing pensions on retirement.[98]
The NZ Super (or Superannuation Fund) which is the first part of the pensions framework in New Zealand, is a Sovereign Wealth Fund which aims to fund the costs of national superannuation in order to reduce the burden on future tax payers. Under this Fund, all New Zealanders who are above the age of 65, receive New Zealand Superannuation Payments.[99] The exact amount of payments made is dependent on a number of factors, including whether the individual resides alone or with a spouse.
The governing legislation for the scheme is the 2001 New Zealand Superannuation and Retirement Income Act, which establishes two main bodies *viz*. the New Zealand Superannuation Fund (which is an asset pool on the balance sheet of the Crown) and the Guardians of New Zealand Superannuation (which is an entity of the Crown charged with the Fund's management).[100] Since the Government's use of the Fund is to assist in making payments for future costs of universal benefits, the Fund supposedly smoothens the cost of super-annuation inter-generationally.[101] The Guardians of New Zealand Superannuation is responsible for managing and administering the Fund, and generates returns by investing the Fund's proceeds. The Fund has been described as a *'long-term, growth-oriented, global investment fund'*. [102]

The responsibilities of the Guardians under the Act include,[103] investing the Fund's proceeds on a prudent and commercial basis, in consonance with principles such as:

a) Best practice portfolio management;
b) Maximizing return without undue risk to the Fund; and
c) Avoiding prejudice to New Zealand's reputation as a responsible member of the world community. [104]

Interestingly, no withdrawals are allowed from the Fund by the Government till 2029/30, which makes it conducive for the Fund to invest in long-term assets, and the Fund follows the principles of responsible investing.[105]

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[98] *'Simple, Effective and (Relatively) Inexpensive: New Zealand Retirement Provision in the International Context'*, Geoff Rashbrooke, Ministry of Social Development, Social Policy Journal of New Zealand (August 2009), available at: https://www.msd.govt.nz/documents/about-msd-and-our-work/publications-resources/journals-and-magazines/social-policy-journal/spj36/nz-retirement-provision.pdf (last accessed on 25 January 2018).
[99] *'Purpose and Mandate: NZ Super Fund'*, NZ Super Fund available at: https://www.nzsuperfund.co.nz/nz-super-fund-explained/purpose-and-mandate (last accessed on 25 January 2018).
[100] Ibid.
[101] Ibid.
[102] Ibid.
[103] *See*, New Zealand Superannuation and Retirement Income Act 2001, § 58.
[104] Ibid.
[105] *'10 Years of Working for the Future of New Zealanders'* NZ Super Fund, (December 2013) available at: https://www.nzsuperfund.co.nz/sites/default/files/documents-sys/10-Year-Performance-Summary-Publication-December-2013.pdf (last accessed on 25 January 2018).

The KiwiSaver scheme forms the second component of New Zealand's pension framework. In essence, KiwiSaver is a voluntary work-based savings initiative by the government which assists individuals in saving for their retirement.[106] A range of membership options exist, with employers playing a vital role.[107] The scheme is administered through KiwiSaver providers, which are essentially organisations which are responsible for managing members' savings.[108] All KiwiSaver schemes are registered and regulated by the Financial Markets Authority, [109] with the KiwiSaver Act, 2006 providing the statutory basis for the scheme. The eligibility criteria to join KiwiSaver are simple - any citizen who is living in New Zealand and is under the age of eligibility for NZ Super (65 years) is eligible to enrol, with employment status not being a relevant factor.[110] Enrolment is done automatically when starting a new job, 'opting-in' through an employer and 'opting-in' through a KiwiSaver provider.[111] In addition to member contributions, there are employer contributions, Government contributions, portability of KiwiSaver accounts and options for early withdrawal.[112] Moreover, though KiwiSaver operates on 'auto-enrolment', it is possible to opt-out as well as choose a 'contributions holiday'.[113]

The KiwiSaver scheme has certain unique features such as the unique incentive and design features of the scheme such as periodical subsidies by the Government, auto-enrolment for workers, participation of a wide age group from 18 to 65 years irrespective of employment status. Employer contributions for the employed, flexibility in the amount of contributions, the number of KiwiSaver providers and sufficient choice given to members (including providing for default options).[114] Additionally, the fact that the KiwiSaver scheme is a nationally branded and incentivised product has helped in its popularity.[115]

2. Australia

The Australian approach to retirement income policy has been described as a 'three-pillar' approach[116] towards solving the problem of providing individuals with retirement incomes.

The scheme in Australia essentially comprises of a means-tested and publicly funded 'Age Pension', compulsory private savings through Superannuation Guarantee arrangements and voluntary private savings which are supported by tax concessions and direct government payments for low income earners.[117] In most cases, retiral incomes are a mix of the above components, with the Age Pension acting as the main source of retirement incomes.[118]

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[106] '*KiwiSaver - How KiwiSaver works & why it's worth joining*' available at: https://sorted.org.nz/guides/kiwisaver-how-it-works (last accessed on 25 January 2018).
[107] '*Who's involved in KiwiSaver*', KiwiSaver, available at: http://www.kiwisaver.govt.nz/new/about/who/, (last accessed on 25 January 2018).
[108] Ibid.
[109] Ibid.
[110] Ibid.
[111] Ibid.
[112] Ibid.
[113] Ibid.
[114] '*Kiwisaver: A Model Scheme?*', Alison O' Connell, Social Policy Journal of New Zealand, (August 2009) available at: https://www.msd.govt.nz/documents/about-msd-and-our-work/publications-resources/journals-and-magazines/social-policy-journal/spj36/kiwisaver-a-model-scheme.pdf (last accessed on 25 January 2018).
[115] Ibid.
[116] '*Australia's retirement income system*', Australian Government, The Treasury, available at: https://treasury.gov.au/programs-and-initiatives-superannuation/charter-of-superannuation-adequacy/report/part-1/ (last accessed on 25 January 2018).
[117] Ibid.
[118] '*The United Nations Questionnaire on social protection of older persons addressed to Governments by the Independent Expert on the question of human rights and extreme poverty: Australia*', available at: http://www.ohchr.org/Documents/Issues/EPoverty/older/Australia.pdf (last accessed on 25 January 2018).

The first component of the system, the Australian Age Pension, is a non-contributory scheme which is intended to act as the bulwark of Australia's social security system, and especially for those with low savings.[119] The targeting of this component is by means of a social security income and assets test, and the Pension is governed through the Social Security Act, 1991.[120] The Age Pension is made available to all Australians conforming to residency requirements, with provisions for payment overseas, reduction in certain cases etc.[121] The pay-out age is generally at 65 years for men and 64 years for women, with there being the scope of the same increasing.[122] The Age Pension is funded from general revenue (that is to say, the Age Pension is non-contributory in nature and funded from tax revenue[123]) and the rates of pension are amenable to bi-yearly adjustment to keep up with factors like the increases in the cost of living.[124]

The second component of the system is the Superannuation Guarantee, which is based on contributions and entails compulsory savings through a system based on employment, with implementation being through the private sector.[125] Employers make contributions in this case, to eligible retiral accounts on behalf of their employees, with there being a prescribed level of employer support.[126] The age at which the accumulated benefits can be tapped into varies, but is set to rise.[127]

The regulation of superannuation funds is done by four bodies including the Australian Prudential Regulation Authority (APRA), Australian Securities and Investments Commission (ASIC), Australian Taxation Office (ATO) and the Superannuation Complaints Tribunal (SCT), with the main legislations governing them including the Superannuation Industry Act, 1993, the Financial Services Reform Act,2 002 and the Superannuation Guarantee Act, 1992.[128]

The third component of Australia's retirement income framework is voluntary superannuation, and private savings/investments.[129] The same is facilitated by tax concessions, and although part of the same system as the compulsory superannuation system, facilitates employers who wish to contribute beyond the Superannuation Guarantee for their employees, as well as allowing for employees' individual contributions.[130] This system of compulsory contributions by employers and employees known as superannuation, is an internationally lauded component. Described as "a unique Australian economic triumph", its goal is to reduce reliance on the state pay-out, known as the age pension, as much as possible.[131]

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[119] Ibid.
[120] Ibid.
[121] Ibid.
[122] Ibid.
[123] '*Sustainability of the Age Pension - Australia*', Prof. Hazel Bateman, School of Risk & Actuarial Studies and CEPAR UNSW Australia, available at: https://www.mof.go.jp/pri/research/seminar/fy2016/tff2016_s4_03.pdf (last accessed on 25 January 2018).
[124] Ibid
[125] Ibid.
[126] Ibid.
[127] Ibid.
[128] Ibid.
[129] Ibid.
[130] Ibid.
[131] '*Australia has the Third Largest Pension Fund Assets in the World*', Edmund Tang (6 July 2016), available at : https://www.austrade.gov.au/News/Economic-analysis/australia-has-the-third-largest-pension-fund-assets-in-the-world (last accessed on 25 April 2018).

3. The United Kingdom

The pensions system in the United Kingdom (UK) is considered both complex and multi-layered and has evolved considerably over time.[132] The main legislations governing the pensions framework in the UK include, among others, the Pensions Act, 2014 and the Pensions Scheme Act, 2017.
There are three main tiers to the UK regime, including a basic State pension to which all individuals contribute and to which almost all individuals have access, thus providing a basic level of retirement income (Tier 1), a second tier (Tier 2) comprising of a State pension related to earning levels of employees, and a third tier (Tier 3) comprising of private pensions which are funded by individuals and/or their employers.[133] While the first two tiers operate on the basis of contributions, the third tier includes pensions that arise from automatic enrolment.[134]

The first tier State pension aims to provide a minimum level of retirement income, and comprises of the basic State Pension (bSP) and additional State pension, the new State Pension (nSP) and means-tested benefits.[135] This is funded on a '*pay as you go*' basis through National Insurance (levied on workers' earnings) and tax revenue.[136] The nSP, which was introduced in 2016, (and which replaced the bSP and additional State Pension) for instance, is contributory in nature with final pay-outs being determined by the number of National Insurance contributions made by individuals before reaching State Pension Age (SPa).[137] The nSP provides a basic income to pensioners who are above the means-tested benefit levels, and is essentially a flat rate-pension payable to an individual on reaching the SPa.[138] State Pensions are essentially based on the National Insurance (NI) contribution record, and there are a range of activities which allow individuals to accumulate State pensions without paying contribution.[139] Additionally, '*contracting out*' is possible,[140] as is deferring the nSP in return for an enhanced pension.[141] However, the bSP continues to operate in respect of certain individuals.[142]
The second-tier pension in the UK, also provided by the State, operates on an unfunded '*pay as you go*' contributory basis through the NI system.[143] This tier is designed to provide people with additional state pensions, are more closely related to their earnings. The self-employed are excluded from the second-tier pensions system, with benefits under this reflecting the contributions made by individuals.[144]
The third tier of the UK's pensions regime is the private pension mechanism, which include workplace pensions and unfunded schemes, and are directed more towards those who are employed, or may be able to take out a pension directly.[145] This tier is funded through both employers and employees and also provides for tax exemption. Though this regime is entirely voluntary, the notion of automatic enrolment exists, primarily since the aim of this regime is to fund an individual's lifetime income.[146]

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[132] '*The Pensions Primer: A guide to the UK pensions system*' The Pensions Policy Institute, (June 2017), available at: http://www.pensionspolicyinstitute.org.uk/uploaded/documents/2017/201706%20PPI%20Pensions%20Primer%202017%20.pdf , page 1 (last accessed on 25 January 2018).
[133] Ibid, page 1.
[134] Ibid, page 1.
[135] Ibid, page 3.
[136] Ibid, page 3.
[137] Ibid, page 3.
[138] Ibid, page 3.
[139] Ibid, page 3.
[140] Ibid, pages 4,5.
[141] Ibid, page 5.
[142] Ibid, pages 9,10,11.
[143] Ibid, page 15.
[144] Ibid, page 15.
[145] Ibid, page 19.
[146] Ibid, page 19.

The UK pension system gives considerable autonomy and flexibility to the recipients in how they choose to provide a retirement income for themselves.[147] This is especially relevant for people from lower income groups, as they usually subject to much more uncertainty than the members of the organised workforce. As a response to calls for more flexibility, the Government removed the effective requirement to use private pension savings to purchase an annuity by age 75.[148]Much like the Australian System, the UK pension-system also incorporates an independent Ombudsman for redressal of consumer grievances[149], which is designed to be simultaneously accessible, efficacious and speedy. The scheme of the Ombudsman system is informal and practical. UK-FOS communicates with consumers in over 40 languages other than English. Similarly, the user interface of their complaint system is designed with customer friendliness at its core.[150]

4. Canada

The Canadian pension model was hailed as one of the best pension models in the world by the World Bank in 2017. This wasn't always the case, though and as recently as the mid-1980s, the Canadian system was plagued by a number of problems such as lack of independent governance, and an almost complete reliance on investment in government bonds, funded primarily on a pay as you go basis and outdated and error prone administration. Canada managed an almost dramatic turnaround in the quality of its pension set-up by relying heavily on the unique expertise of a number of diverse stakeholders- labour, government, business, and finance.

Three important factors make Canada a trendsetter among modern pension regimes- *Firstly,* the building and maintenance of trust among a diverse range of relevant pension stakeholders; *Secondly*, adherence to a set of pension design and management principles that cut across a variety of pension disciplines, including governance, people and organization, investment, administration, plan design and funding, and regulation and public policy; and *Thirdly,* results-focused *execution* that puts the principles into practice on a day-to-day basis and delivers superior results.[151] Canada highly prioritizes strong independent governance of pension plans, making it one of the most important elements of their pension model. Other important features include (high) scale, in-house management by professionals (who are appropriately incentivized), diversification (by both geography and asset class), a strong emphasis on obtaining and retaining talent, and a long-time horizon. [152]

Canada's retirement income system can be characterized in terms of three main components or "pillars". Pillar I provides a basic income guarantee for seniors through two publicly financed programs, Old Age Security (OAS) and Guaranteed Income Supplement (GIS). OAS is paid at age 65 to Canadians who meet residency requirements. The maximum annual benefit is $6,800 (2016). For those with earnings greater than $73,800 (2016), OAS benefits are reduced and eventually eliminated. GIS is an income-tested program that provides additional income to seniors who reside in Canada and live in lower-income households.

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[147] Ibid, page 34.
[148] Ibid, page 34.
[149] '*Report of the Task Force on Financial Redress Agency*', Government of India, available at: https://dea.gov.in/sites/default/files/Report_TaskForce_FRA_26122016.pdf (last accessed on 26 April,2018).
[150] Ibid.
[151] '*The Evolution of the Canadian Pension Model-Practical lessons for building world class pension organizations*', International Bank for Reconstruction and Development / The World Bank, available at: https://openknowledge.worldbank.org/bitstream/handle/10986/28828/121375.pdf?sequence=4&isAllowed=y, (last accessed on 25 January 2018).
[152] Ibid.

Pillar II includes the Canada Pension Plan (CPP) and Québec Pension Plan (QPP), which are mandatory earnings-related programs for the employed and self-employed in Canada and Québec. CPP and QPP provide a range of benefits including retirement, survivor, and disability benefits, as well as benefits for children of deceased and disabled contributors. These are contributory plans that require a combined employer-employee contribution of 9.9 percent (10.5 percent for QPP) of earnings between $3,500 and the year's maximum pension earnings ($56,900 in 2016), shared on a 50/50 basis. These plans aim to replace 25 percent of pensionable earnings, and the benefits are portable throughout Canada and can be drawn at age 65. They can also be drawn earlier and or later using reduced or increased payment formulas.

Pillar III of the Canadian system consists of workplace pensions and private savings plans that allow for additional earnings replacement in retirement. These include registered pension plans (RPPs) with an employer, union, or other sponsor; individual or group Registered Retirement Savings Plans (RRSPs); and, since 2009, Tax-Free Savings Accounts (TFSAs). All of these vehicles offer favourable tax treatment.[153]

In the mid-1990s, Canada's federal and provincial governments passed a series of reforms to the CPP based on concerns of unsustainability and mounting inter-generational inequity, i.e. heavy subsidies being borne by the younger generations for the older counterparts. Several long-term policy decisions were taken at this point and the government, along with leaders in the pension and policy sphere was successfully able to harness a pension fiscal crisis into building a reformed world class pension model. The global financial crisis in 2008 further led to the learning of important lessons for the pensions regulator- the need to better manage risk and the importance of managing relationships with various stakeholders. [154] Subsequently, measures were put in place to give effect to these principles.

5. Chile

The Chilean pension system is regarded as one of the most well-developed pension systems, especially amongst developing nations. While pensions in Chile started in an ad-hoc manner, the shift towards a formalized pension sector begun in 1980 with the introduction of systemic pension reforms by the government. The new Chilean pension system consists of four main tiers. All pension savings are managed by external funds and providers.

a. **The new solitary pension**: Introduced in March 2008, it replaces the previous poverty prevention programs with a unique scheme that guarantees that all individuals in the 60% less affluent fraction of the population will have a guaranteed basic pension, regardless of their contribution history. [155] This is funded by tax revenues.
b. **The comprehensive pension system**: It is a mandatory, fully funded, defined contribution system in which pensions are paid out based on individuals' savings during their employment. Workers are mandated to contribute 10% of their salaries, plus applicable administrative charges and additional premiums. The administration of these funds is highly regulated to protect the interests of the beneficiaries. There is also a body of approved fund administrators approved by the government (AFPs). The AFPs are private, highly specialized bodies, and are subject to regulation, to protect the assets of the members, reduce risk, and

[153] Ibid.
[154] Ibid.
[155] '*Chile: Review of the Private Pensions System*' OECD (October 2011), available at: http://www.oecd.org/finance/private-pensions/49497472.pdf (last accessed on 26 April 2018).

work efficiently in the best interest of the members. The AFPs are also separate from the funds they manage, thereby ensuing insulation and safeguarding of the fund itself.

A new law implemented in August 2002 requires each AFP to mandatorily offer four different types of funds, called simply Funds B, C, D and E, which vary according to the degree of risk. AFPs may also voluntarily offer Fund A. The funds are differentiated by the proportion of their portfolio invested in variable income securities (such as equities) and fixed income (such as bank deposit, mortgages, or government bond that offer a low level of risk or variability).[156] The new Chilean design lets the members choose freely among the different funds. The only limitation is for pensioners, male members over 55 years old and female members over 50 years old. Pensioners may choose only the Funds C, D and E, which have a lower relative risk, whilst members who are within 10 years or less of the legal retirement age may access to the fund type B, C, D and E, which involve relatively less risk.[157] The system provides for freedom of choice and a minimum investment return rule.

c. **Voluntary pension savings**: In addition to the Compulsory Pension System, there are also voluntary pension savings plans provided by the AFP's and other authorized entities, such as insurance companies, mutual funds, fund managers, etc. Employers may contribute to their employees' pension savings above the mandatory requirements in the compulsory pension system through Voluntary Pension Savings.[158]

d. **Occupational pension plans-collective voluntary pension savings**: This type of pension plan is a contract between the employer and authorized institutions to manage voluntary collective pension saving funds. This agreement is made by the employer in representation of its employees who want to join the plan.[159]

6. Key Takeaways

The international examples mentioned above throw light on a number of international best practices which can be helpful in further refining the pensions regulatory framework in India.
A recurring theme in all the national frameworks studied is the emphasis on a simple and easily comprehensible pension framework. In the specific context of the pensions framework in New Zealand, one aspect which is striking and which is also responsible for the popularity of the same, is the fact that the same is composed of two main schemes, which cover the entire intended audience. This is in contrast to India which is fragmented and regulated by multiple regulators, and also has coverage gaps.

Canada and Chile show how long-term thinking and the involvement of various stakeholders can yield favourable results when it comes to pensions and lead to turnaround in the social security framework of a country. Both these countries, while being mindful of their social realities, extend considerable autonomy to the beneficiaries of pension schemes and plans.

Another important takeaway from these nations is the extensive reliance on independent expertise in every step of the process. A few lessons which India can learn from these nations is to rely more on experts for various functions like fund management, take active steps to incentivize individuals

[156] Ibid.
[157] Ibid.
[158] Ibid.
[159] Ibid.

in order to attract and retain the best talent, and to start approaching pension policy making in a more structured, rather than an ad-hoc manner. Canada and Chile have shown commendable efforts in revamping the pension system to address long term concerns of preventing inter-generational inequity, which given India's demographic is likely to be a huge concern in the near future. UK and New Zealand are particularly pertinent examples of how far giving greater autonomy and higher incentives to the subscribers can go in increasing enrolment numbers. The strong ombudsman feature in the UK plays a significant role in enhancing subscriber confidence and has been discussed in greater detail in the next chapter in the context of improving the consumer redressal mechanism for the pensions sector in India.

IV. CASE STUDY: THE ATAL PENSION YOJANA

Having discussed the regulatory gaps in the present model of governance of pension schemes in India, this part of the Report examines the challenges identified, and the reforms suggested in the context of one particular pension scheme administered by the PFRDA- the Atal Pension Yojana (APY), which is the only pension scheme of the PFRDA targeted specifically towards the unorganized sector.

The institutional design of social security schemes in India (there are a number of state and central level social security schemes in existence in India, going into the details of which is beyond the scope of this paper) itself is fragmented, and spread across multiple authorities, and laws. There are multiple social security schemes administered by the PFRDA, the Ministry of Finance and the Ministry of Labour and Employment. Further, there are a number of social security schemes at both the Central and the State level. While going into too much detail on this point is beyond the scope of this paper, the authors would like to draw the attention of the readers to the fragmented structure of governance of pension and social security schemes in India, and suggest a relook with the aim of providing for a clearer, more efficient and less expensive system of governance.

The APY has been chosen as a case study for a number of reasons. Firstly, as pointed out above, the APY is the only formal pension scheme geared towards the unorganised sector. To put this into perspective, out of the total number of estimated employed persons in 2011-12 on usual status basis (47.41 crore), 82.7% of the workforce (39.14 crore persons) were in the unorganised sector[160]. The 'informal economy' also contributes nearly half to the total GDP[161], a ratio which is among the highest in the world and is comparable to sub-Saharan Africa[162]. Members of this cohort are characterized by a number of distinguishing features which set them apart from their counterparts who are formally employed. Secondly, a majority of them live below the poverty line and the consequent lack of access to safety nets to deal with contingencies such as ill health, accidents, death and other exigencies, increases the probability of them squandering whatever little financial savings they have on these exigencies. As a result, members of the unorganised sector are frequently forced to delay and put off retirement together. The resultant toll on their overall health and well-being is significant. Further, any exigency can have a disastrous effect on their already precarious financial state. These workers are also scattered, and resultantly, lack a unified voice. It is therefore unsurprising that there is a high congruence between the poor, and the vulnerable. Lastly, because of their unstable financial conditions, factors like tax exemptions and other deductions which are used to incentivize the organised workforce to save, hold no meaning for them. Therefore, when it comes to encouraging this sector to save, a completely different approach and incentive structure need to be resorted to.

To address some of these concerns, the Unorganised Workers Social Security Act (UWSSA)[163], was enacted in 2008 . Subsequently, the NPS Lite/ Swavalamban scheme was launched in 2010. Touted as a specialized scheme for the unorganized sector, this scheme was targeted for people belonging to low income groups to enable them to plan for their retirement even with small investment amounts

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[160] '*Workforce in Organised/ Unorganised Sector* ', Press Information Bureau, Government of India Ministry of Labour & Employment, (25 July 2016), available at: http://pib.nic.in/newsite/PrintRelease.aspx?relid=147634 (last accessed on 25 January 2018).

[161] Ibid n7.

[162] '*Informal Economy and the World Bank*', The World Bank, Poverty Reduction and Economic Management Network, Economic Policy and Debt Department (May 2014), available at: http://documents.worldbank.org/curated/en/416741468332060156/pdf/WPS6888.pdf (last accessed on 25 April 2018).

[163] The Unorganised Workers' Social Security Act, 2008, available at: http://labour.tripura.gov.in/sites/default/files/The_Unorganised_Woekers_Social_Security_Act_2008.pdf (last accessed on 26 April 2018). *(Hereinafter* 'Social Security Act 2008'*)*

of Rs. 100 per month. An offline service, NPS Lite was designed to ensure very low administrative and transactional costs for investors. The NPS Lite/Swavalamban was subsequently revamped as the APY- for all unorganised sector workers in the age group of 18-60. However, the response to the APY scheme has been far from encouraging. Till February 2017, only 70 lakh subscribers[164] had opted for this scheme, which amounts to less than 1% of India's 44 crore unorganised workers.

It must be noted that Indian households require customised solutions that vary across the country, as well as across age and wealth distributions.[165] The heterogeneous nature of Indian households and the relatively low levels of income, education and financial sophistication mean that it is difficult for service providers to justify reaching them unless solutions are scalable and can be implemented at very low cost.[166] Further, the lack of trust in financial institutions partly explains the tendency of households to avoid financial products and instead invest in physical assets such as gold[167]. All of these are issues which need serious attention to devise customised solutions for greater financial inclusion (including access to pension products) among India's unorganised sector. Therefore, given the criticality of the APY, which is only expected to increase as the elder population keeps burgeoning, it is opportune to revisit the discussions in the previous chapters of this Report and offer some suggestions for reform, particularly for the APY. This chapter also looks at some 'best practices' for pensions and offers specific considerations for the unorganised sector.

According to our analysis, the APY is found lacking in these broad areas, and could benefit immensely from both regulatory reforms, as well as adoption of national and international best practices in this respect:

1. **Clarity in intent**: The APY stated that it would be "*focussed on all citizens in the unorganised sector*", who join the NPS administered by the PFRDA and who are not members of any statutory social security scheme." While the APY does not explicitly refer to the definition provided under the UWSSA, 2008[168], this is the only legislation that has attempted to formally codify the scope of the term-'*unorganised sector*'[169]. Considering that the APY is targeted specifically for the unorganised sector, clarity in the scope and meaning of these terms is of utmost importance. However, a number of deficiencies in the definition of 'unorganised sector' in the UWSSA itself have been noticed. For instance, section 2(k) and (n) of the Act defining "*self-employed workers*" and "*wage workers*" authorize the Central Government to notify the monthly earnings required to be considered as such workers; conferring an arbitrary power to specify the coverage of such worker. In this regard, the UWSSA also fails to provide any guidelines or prescriptive values to be followed for such specification by the Government.[170] Notably, most labour laws are applicable to workmen/employees earning a stipulated amount. In many cases, such amounts are mentioned

[164]'*NPS, Atal Pension Yojana subscriber base crosses 18 million mark*', Livemint (10 November 2017), available at: http://www.livemint.com/Money/Evv6heTTRCifyEku2n0j7H/APY-NPS-subscriber-base-crosses-18-million-mark.html (last accessed on 24 January 2018). (*Data as on 31 October 2017*)
[165] Ibid n3.
[166] Ibid.
[167] Ibid.
[168] Ibid n163.
[169] ***Section 2(l)*** of the Social Security Act, 2008 defines the "*unorganised sector*" as "*an enterprise owned by individuals or self-employed workers and engaged in the production or sale of goods or providing service of any kind whatsoever, and where the enterprise employs workers, the number of such workers is less than ten.*"; ***Section 2(m)*** of the Social Security Act 2008 defines an "*unorganised worker*" as "*a home-based worker, self-employed worker, a wage worker in the unorganised sector, and a worker in the organised sector not covered under any of the Acts listed under Schedule II.*"
[170] It is important to note that no such notification could be found.

in the principal legislation.[171] In this regard, two approaches are possible. Firstly, the monthly earnings are specified in the Act itself (to ensure that the Government cannot arbitrarily change the threshold and must follow the Parliamentary amendment process). Alternatively, with a view to provide flexibility to the Government to determine the monthly earning which will depend on various socio-economic parameters, only a power to notify the monthly earning may be provided for in the Act (as is the case right now). However, as suggested in such a case, guiding principles for such exercise of power must be set out in the Act itself.

Therefore, as has been pointed out in Chapter II above, the definition of the "unorganised sector", in the light of the special pension schemes applicable to them, should be inserted in the PFRDA Act itself.

2. **Fragmented Structure**: As has been pointed out above, the institutional design of social security schemes in India is fragmented, and spread across multiple authorities, and laws. For instance, while the NPS is regulated by the PFRDA and operationally supervised by the NPS Trust; some other schemes like the Aam Admi Bima Yojana are under the aegis of the Ministry of Finance, and the Draft Labour Code on Social Security[172] (Code) is under the Ministry of Labour and Employment, which also establishes, for the administration of social security, an authority to be known as the 'National Social Security Council of India'. Insurance schemes, including micro-insurance schemes for the marginalised sector are under the regulatory supervision of the IRDA. In the specific context of India's fragmented pension structure, it is worthwhile to reflect on the pensions framework in New Zealand, which is composed of two main schemes, which cover the entire intended audience, thereby contributing to its simplicity and immense popularity, as has been mentioned earlier in the Report.

   In the Indian context, further refining the pensions framework (which as discussed is fragmented and regulated by multiple regulators, and also has coverage gaps) based on such a model may be an idea which could be taken up.

3. **Consumer Protection and Education:** Pensions, because of their very nature, mandate a heightened degree of scrutiny and adequate safeguarding of consumer interests, including both consumer protection as well as consumer education. Consumer protection is a critical part of any financial product, especially a pension product. A holistic consumer protection framework extends to stages before and after the mere transaction of buying a financial product. Be it adequate disclosures before the transaction, or continued consumer support after, it covers a gamut of responsibilities on part of the financial service provider. This is especially critical for the unorganised sector, considering the pervasive lack of both education and financial sophistication of this group. As has been pointed out by both the IFC and the Bose Committee Report[173], a fundamental shift from *caveat emptor* (*buyer beware*) to *seller beware* for financial services is required, because of the peculiar situation of vulnerability and dependence of financial consumers.

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[171] *See*, The Payment of Wages Act, 1936, § 1(6). Under this sub-section, the Central Government may either notify the specified level of wages by notification, or the wage as specified in the parent legislation. The qualifying level of wages is whichever one of the two is higher.
[172] Code.
[173] '*Report of the Committee to recommend measures for curbing mis-selling and rationalising distribution incentives in financial products*' (November 2014), available at https://www.finmin.nic.in/sites/default/files/Final_Report_Committee_on_Incentive_Structure_0.pdf (last accessed on 8 April 2018).

The low coverage in terms of subscriber base of the APY speaks a lot about the lack of awareness and literacy. Behavioural factors such as lack of self-confidence, often act as impediments in engaging with formal financial systems[174]. Moreover, as has already been documented, the lack of participation in the market for life insurance products appears to be related to the self-perceived financial management skills of the household head.[175] This problem is compounded by the fact that the APY documentation does not contain a holistic list of rights and remedies available to consumers, helpline numbers, etc. Effective communication includes providing regular individualised benefit statements etc. In addition, clear benefit projections under prudent assumptions, informing members about the possible impact of higher contributions or later retirement on their benefits should also be made available. Plan members must necessarily have free and ready access to comparative information about costs and performance of different providers, and the language used in disclosed materials should readily be understood by them.[176] Efforts in training and educating the beneficiaries of schemes such as the APY have also been largely missing. Because the incentives for intermediaries for APY are very low, this reflects in a lack of interest in providing the required levels of services and information. The Financial Sector Development Commission had declared in 2013 that consumers must be provided with fair disclosure of information.[177] Further, the ground breaking Financial Sector Legislative Reform Commission (FSLRC) report[178] suggested that a consumer protection mechanism should consist of the following:

1. Set of rights and protections for the customer
2. Set of powers for the regulator
3. Guiding principles on what should be used and when

While the PFRDA Act does prescribe certain powers for the regulators, guiding principles on their application is missing. The Reserve Bank of India prescribes a detailed charter of consumer rights[179] which enunciates basic rights available to all consumers including right to fair treatment, right to transparency, right to grievance redressal and compensation, and the right to education. A similar scheme should be considered for pension subscribers as well (albeit with necessary modifications), especially for schemes like the APY. Indeed, as suggested by noted economists Jean Dreze and Ritika Khera, a "*rights-based approach*" is relevant when it comes to disadvantaged groups because it gives some semblance of power to these groups and a mechanism to adequately assert and enforce these rights[180].

The grievance redressal framework prescribed by the PFRDA (which is applicable to subscribers under the APY as well[181]) is found particularly lacking in a number of ways which have been discussed earlier in the report. However, when seen in the context of APY, this entire system of grievance redressal, makes it inaccessible, complicated, and the involvement of too many authorities, with their powers spread out under various regulations. Moreover, features like

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[174] Ibid n3.
[175] Ibid.
[176] The OECD Roadmap for the Good Design of Defined Contribution Private Pension Plans', OECD (June 2012) available at: http://www.oecd.org/finance/private-pensions/50582753.pdf (last accessed on 25 January 2018)
[177] Ibid n149.
[178] Ibid n91.
[179] '*Charter of Consumer Rights*', Reserve Bank of India (December 2014) available at: https://rbidocs.rbi.org.in/rdocs/content/pdfs/CCSR03122014_1.pdf (last accessed on April 12 2018).
[180] '*Recent Social Security Initiatives in India*', Jean Dreze and Ritika Khera (October 2017), available at : https://www.sciencedirect.com/science/article/pii/S0305750X17302097?via%3Dihub (last accessed on 10 April 2018).
[181] '*Grievance Redressal under APY*', PFRDA Circular No. PFRDA/4/APY/62 (15 December 2016) available at: https://npscra.nsdl.co.in/download/Grievance%20redressal%20under%20APY-Circular.pdf (last accessed on 25 January 2018).

English being the sole language of the grievance redressal portal and the absence of any vernacular language, exacerbates the notional inaccessibility and reluctance of the intended beneficiaries to enter the formal financial system. If the enrolment numbers in the APY have to improve, this scheme has to be made attractive and appealing to the intended base. Simplification of norms, providing information in vernacular languages, and setting up of an easily navigable redressal mechanism are the need of the hour. Especially for the last, the UK system offers strong examples of simple, tailored solutions such as doing away with procedural impediments and utilizing techniques of mediation, allowing registering of complaints over the telephone. Measures like this can be implemented in some form in the PFRDA framework for the benefit of the subscribers and the regulator alike.

As regards best practices within the Indian regulatory framework, reference can be made to SEBI's Office of Investor Assistance and Education (OIAE), which is a single point interface for handling subscriber complaints as well as education outreach efforts.[182] As of now, the PFRDA framework debars communication seeking guidance or explanation. A centralised body handling both consumer grievances and education efforts would go a long way in mitigating these concerns. While the PFRDA's step of appointing IL&FS Skill Development Corporation Ltd. to create mass awareness and impart training on pension schemes under NPS and APY to employees of the Points of Presence (POPs)/ POP Service Providers/APY Service Providers[183] is a good start, further work needs to be done in order to ensure that adequate awareness is created amongst the ultimate beneficiaries of the pension schemes, and to that extent further targeted intervention may be necessary. Education and outreach efforts must also extend to various intermediaries, to not only ensure that they are technically competent, but also so that they give due consideration to factors like full and fair disclosure, likelihood of conflict of interest, protection of confidentiality of consumer information, etc.

Therefore, subscriber education and redressal should go hand in hand as the two are often inextricably linked, especially for disadvantaged groups like the unorganised sector.

4. **Incentives to enrol and barriers to entry and exit:** Features which incentivize people to enrol and contribute for long periods are important hallmarks of any pension scheme, especially for disadvantaged groups. It should be borne in mind that unlike most other financial products, pension products may need to be actively 'pushed' or marketed to households, especially since the target audience includes low income households in the unorganised sector,[184] who would most likely lack access to formal financial services, and be less likely to invest their money readily, for a faraway future. To that extent, appropriate interventions should be considered to disseminate information about the same to the targeted beneficiaries of the APY scheme.

   The disappointing number of enrolments in the APY scheme points to the pressing need for building in incentives to market the product to the target audience, which in this case, is the majority of India's unorganised sector workforce. Subscribers who wish to avail of the APY need

[182] '*Office of Investor Assistance and Education (OIAE)*', Securities and Exchange Board of India (SEBI) available at: https://www.sebi.gov.in/department/office-of-investor-assistance-and-education-19/overview.html, (last accessed on 26 April 2018).
[183] '*Notice on the Appointment Of Training Institute For Imparting Training On Pension Schemes Regulated/Administered By Pension Fund Regulatory And Development Authority (PFRDA) For North West Zone*' Pension Fund Regulatory and Development Authority (21 February 2017) available at: http://www.pfrda.org.in/WriteReadData/Links/IL&FSa7a5bed4-8f08-4eea-b29a-09ca0f6f8d03.pdf (last accessed on 25 January 2018).
[184] Ibid n3.

to mandatorily have a bank account and a mobile phone.[185] Additionally, providing an Aadhar number has also been made compulsory to access the APY scheme recently.[186] It is interesting to note that while a notification[187] issued by the Department of Financial Services, Ministry of Finance makes furnishing proof of possession of Aadhaar number or undergoing Aadhaar authentication compulsory for being eligible to receive benefits under the Scheme, the PFRDA 'frequently asked questions' page on the APY specifically clarifies that Aadhaar is not compulsory for receiving benefits under the Scheme. Making the Aadhaar compulsory is not conducive to enrolling a large part of the unorganised workforce under the ambit of the APY, and is particularly discriminating for being exclusionary. It is pertinent to note that the Supreme Court has also questioned the practice of compulsory linking of welfare schemes to Aadhar.[188] Therefore, the policy decision behind making Aadhar compulsory for the APY needs a serious revisit.

Further, for users who wish to migrate from the erstwhile Swavalamban scheme to the APY, this shift can only be made in the age bracket of 18 to 40 years.[189] The rationale for having an age limit may be to reduce fiscal liabilities, but having such a prescriptive age limit is not clear. In fact, this ends up excluding a significant portion of the targeted cohort (31 %, as per the 2011 census) from the applicability of the scheme. Further, the practice of freezing of accounts after 6 months of non-contribution and deactivation after 12 months can act as potential disincentives.[190]

Members of the unorganised sector, because of their unfamiliarity with the formal financial system are often uncomfortable with personal and formal interactions with financial service providers. The use of technology to avoid potentially embarrassing face-to-face situations (for the subscribers), which happens to be a pervasive problem in the context of household level financial decisions in the Indian context,[191] should be leveraged to address this. In this regard, the Report of the Task Force on Financial Redress Agency[192] also suggested extensive use of physical letters, SMS, missed calls, video and app-based services to allow subscribers to register their grievances. The importance and efficacy of relying upon local networks whilst selling financial products in India was also recognised in a recent Report on financial sector developments in India.[193] The same paper also spoke about how adopting new practices cannot be bought and rather have to be induced in a number of ways, including inducing behavioural changes by using gentle nudging. The use of network effects is also critical in this respect. If people see their contemporaries using a service, they are more likely to adopt it as well.[194] People with low incomes and low savings could be less focussed about their savings and long-term

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[185] '*Frequently Asked Questions -Atal Pension Yojana*', PFRDA, available at: http://pfrda.org.in/MyAuth/Admin/showimg.cshtml?ID=719 (last accessed on 25 January 2018).
[186] '*Aadhar seeding and authentication in Atal Pension Yojana*' PFRDA notification no. PFRDA/03/05/0006/2017-PnD-APY, PFRDA (26 December 2017) available at: http://www.pfrda.org.in/MyAuth/Admin/showimg.cshtml?ID=1252 (last accessed on 25 January 2018).
[187] '*Aadhar seeding and authentication in Atal Pension Yojana*', PFRDA, (26 December 2017) available at: http://www.pfrda.org.in/MyAuth/Admin/showimg.cshtml?ID=1252 (last accessed on 26 April 2018).
[188] '*Centre admits there was no Supreme Court order on mandatory Aadhaar-mobile number linking*', Scroll.in, available at: https://scroll.in/latest/876927/centre-admits-there-was-no-supreme-court-order-on-mandatory-aadhaar-mobile-number-linking (last accessed on 26 April 2018).
[189] '*Atal Pension Yojana (APY) - Details of the Scheme*', available at: https://npscra.nsdl.co.in/nsdl/scheme-details/APY_Scheme_Details.pdf (last accessed on 25 January 2018).
[190] Ibid.
[191] Ibid n3, pages xii, 74.
[192] Ibid n149.
[193] 'A Vision and Action Plan for Financial Sector Reforms in India', Isha Agarwal & Eswar Prasad, Brookings India, (January 2018) available at: https://www.brookings.edu/wp-content/uploads/2018/01/biic_20180114_es2.pdf (last accessed on 25 January 2018)
[194] Ibid.

financial planning, given these are not their immediate needs. Therefore, institutions are critical for raising awareness and creating access to financial products like social security.

Cost being a significant factor in any financial product or service, high transaction costs in financial services are a big impediment for the unorganised sector.[195] Complicated paperwork and bureaucratic impediments can exacerbate feelings of inaccessibility to the system for low income and poorly educated households in their initial engagement with financial markets.[196] The details of the APY scheme [197] have revealed that the only initial requirement was to have a bank account. Now, to derive benefits, subscribers need to mandatorily have an Aadhaar number in addition. Conditions such as these increase the notional cost of enrolment for the unorganised sector. Additionally, banks are also required to collect additional amount for delayed payments, such amount will vary from minimum Re 1 per month to Rs 10/- per month.[198] This further highlights the lack of accessibility of the scheme for its targeted audience. The Household Finance report also stressed upon the need to eliminate or reduce informal transactions costs, such as filling in forms, and bureaucratic impediments such as certification and verification costs, will need to be undertaken simultaneously. Regulators and service providers should strive to provide quick, cost effective, seamless switching between different financial products[199].

The transition from the NPS-Lite/Swavalamban to APY itself seems to have been designed half-heartedly. All the existing NPS-S customers are to be migrated to the APY with an option to opt-out, placing the responsibility of opening bank accounts for NPS-S customers on the aggregators, and the burden and cost of acquiring an Aadhaar number on the subscriber. In case of those who wish to continue with the NPS-Lite i.e. use the NPS without the co-contributions, the PFRDA ought to define well-defined standards of skill and care that aggregators will be expected to exercise towards a customer, as invariably the aggregator will end up playing the role of an advisor when making a decision on whether to opt-out of the APY, or continue only the APY, or continue the APY along with NPS-Lite. The scheme also levies penalties on those who are not able to maintain the required balance in the savings bank account for contribution on the specified date and closes bank accounts if contributions are not paid for 24 months. These design concerns, have a likelihood of defeating the purpose of providing a formal sector savings mechanism[200] to a vulnerable part of the population.

When it comes to exiting the scheme, NPS -Lite/Swavalamban subscribers are permitted to withdraw the entire corpus only if they have completed 25 years in the system; and if the accumulated wealth is less than Rs. 1 lakh[201]. This seems to be problematic and some concessions may be considered (especially in terms of the time-frame), primarily considering that the target audience for these schemes (individuals in the unorganised sector) may have no other source of savings and may need to access their retiral funds in times of financial crises and general emergencies. In a recent move, the PFRDA has relaxed the partial withdrawal norms for NPS

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[195] Ibid n3,pages xi-xii.
[196] Ibid.
[197] '*Atal Pension Yojana - Details of the Scheme*' available at: https://npscra.nsdl.co.in/download/non-government-sector/all-citizens-of-india/forms/APY-Scheme%20Details.pdf (last accessed on 25 January 2018).
[198] '*Atal Pension Yojana - Training Manual*', PFRDA, available at: https://npscra.nsdl.co.in/nsdl/scheme-details/Atal%20Pension%20Yojana%20Training%20Manual.pdf, page 6,(last accessed on 25 January 2018).
[199] Ibid n3.
[200] '*Concerns about Atal Pension Yojana*', Renuka Sane, (26 May 2015), available at: http://www.marketexpress.in/2015/05/concerns-about-atal-pension-yojana.html (last accessed on 25 January 2018).
[201] Exit Regulations, 2015, Second proviso to Regulation 5(b).

subscribers[202]. NPS subscribers who have contributed for three years can now withdraw up to 25% of the corpus subject to conditions such as specified illness including family members, education of children, marriage expenses of children and purchase or construction of house[203], no similar relaxation seems to have been explicitly provided for NPS-Lite/APY subscribers, who need this as much, if not more than their NPS counterparts.

Therefore, barriers to entry and exit can not only disincentivize people from investing in pensions outright but also have the tendency to prevent them from making continued investments to secure their future. In the light of the vulnerabilities of the APY, suitable modifications must be made to make it both easier to access, but also to navigate, and finally exit.

5. **Conflict of Interest:** Multiple financial committee reports in India including the FSLRC and Report of the Task Force on Financial Redress Agency have pointed out the inherent conflict of interest in financial regulators marketing the products they also administer and regulate. The PFRDA is not only responsible for the administration of the APY, but also for regulating the overall pensions landscape in India, creating a high likelihood of conflict of interest. A method which has been followed to tackle this issue in a number of jurisdictions such as the United Kingdom, is to gradually move away from the commission model to a fee-for-advice model when it comes incentivization of aggregators[204].

   Though this may not be possible at this point in a developing country like India, where aggregators are often responsible for dispensing financial advice to large swathes of unsophisticated consumers, a gradual separation of the regulatory and administrative functions of PFRDA, accompanied by the setting up independent agencies for dispensing pension and other financial advice is the need of the hour.

6. **Appropriate Investment Strategies**: Under the NPS, there is a default investment strategy for the Government Sector/NPS Lite, as well as for non-government private sector subscribers, and private citizens.[205] For NPS-Lite and Swavalamban subscribers specifically, at least 40% of the accumulated pension wealth is annuitised to yield a monthly pension of at least Rs. 1000, and the balance is paid out. Further, where the accumulated pension wealth does not exceed Rs. One lakh or a specified limit, the entire corpus is to be paid out to subscribers who have not availed of the co-contribution under Swavalamban, but there is a waiting period of twenty-five years if the Swavalamban co-contribution has been availed; [206]

   While the NPS and NPS Lite schemes provided for market linked returns and compulsory annuitization of 40% of the corpus at the time of exit i.e. 60 years for the NPS Lite scheme, there is no such provision under the APY. The amount collected under APY are managed by Pension

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[202] '*Circular on Guidelines on Process to be followed by Subscribers/Nodal Office/PoP/ Aggregator for Processing of Partial Withdrawal Request*', Circular No. PFRDA/2018/40/Exit., PFRDA (10 January 2018) available at: http://www.pfrda.org.in//MyAuth/Admin/showimg.cshtml?ID=1277 (last accessed on 25 January 2018).
[203] Ibid.
[204] Ibid n173.
[205] Ibid n76, Chapter VI.
[206] However, there is no guarantee that an annuity, even if purchased, with the entire accumulated corpus, would yield a monthly pension of Rs. One thousand. *See*, the Exit Regulations, 2015, Second proviso to Regulation 5(b).

Funds appointed by PFRDA as per the investment pattern specified by the Government.[207] There seems to be no policy reasoning behind this distinction and as such, needs to be looked into.

An APY subscriber has no option to choose either the investment pattern or pension fund. This may need to be revisited, given that the possibility of generating increased returns should be an area meriting interest, especially considering that for the target audience which is the unorganised sector, the returns generated by market-linked investments may be the only way to generate higher retiral incomes in old age. This may need to be complemented with a robust disclosure and financial advice framework, so that the subscriber is made aware of market risks and can make an informed decision about which investment pattern may be most suitable.

Good investment strategy necessitates the pension fund's investment policy to be consistent with legal provisions (prudent person standard and quantitative limits) and the objectives of the pension fund (i.e. with the characteristics of the liabilities, maturity of obligations, liquidity needs, risk tolerance etc.). With regard to investment of the contributions under APY, the amounts collected under APY are managed by Pension Funds appointed by the PFRDA as per the investment pattern specified by the Government. The subscriber has no option to choose either the investment pattern or Pension Fund.

In order to ensure that the pension corpus of low-income customers is not eroded over time, the government needs to index both the subscriber contribution and the matching contribution to inflation. Further, the current NPS-S investment mix invests up to 85% of the corpus in bonds and up to 15% in equity, the remaining comprising of corporate bonds. In contrast, the NPS-Main follows a life-cycle investment mix which invests 50% of a 20-year old subscriber's corpus in equity, 30% in corporate bonds, and 20% in government bonds. As the subscriber ages, the share of equity and corporate bonds is reduced and transferred to the less-volatile government bonds. This is at odds when compared to even other developing countries like Chile. Notably, when the pension system was first introduced in Chile, the investment guidelines reflected the small and unsophisticated capital markets. Commentators have opined that investing in the life cycle fund mix could provide returns that are 49% higher than the returns on the current NPS-S mix. While guaranteeing a minimum amount through investments in approved fixed income instruments, the government could ensure that subscribers can accumulate corpuses that vastly exceed the guaranteed benefit by shifting to a more equity-heavy investment mix depending on age of the subscriber.[208]

The previous NPS Lite/Swavalamban scheme offered a much more forward-thinking approach with respect to investment guidelines and gave much more autonomy to the subscribers in how to utilize their savings. While some degree of caution is justified, it should not come at the cost of ensuring maximum returns to the subscribers.

7. **Distribution channels for APY:** Currently, bank branches are primarily responsible for the distribution of this products. This is a limited approach as banks are bound by their own restrictions ranging from the economic feasibility of the incentives offered to the range of competing products sold from within the same portals of a bank branch.[209] Creating strong distribution networks by leveraging existing informal networks within the community, more

[207] '*Atal Pension Yojana Rules*', Ministry of Finance, Department of Financial Services (16 October 2015) available at http://www.jansuraksha.gov.in/Files/APY/English/Rules.pdf (last accessed on 25 January 2018).
[208] '*An Initial Analysis of the Atal Pension Yojana*', Vishnu Prasad & Anand Sahasranaman, IFMR Finance Foundation (9 March 2015), available at: https://www.dvara.com/blog/2015/03/09/an-initial-analysis-of-the-atal-pension-yojana/ (last accessed on 26 April 2018).
[209] Ibid n173.

extensive use of post offices, and the use of innovative use of entities such as telecommunication service providers should be considered[210].There is also a need to adopt measures which streamline the delivery of and access to financial products that are relevant for Indian households.[211]

The success of a financial product hinges substantially on the channels of distribution which make it reach the intended beneficiaries. Considering the length and breadth of India, the immense diversity and overarching local conditions, the government and the regulators should aim to maximize cheap, efficient and local networks to ensure that pension services such as the APY reach the largest numbers of intended beneficiaries.

8. **Control and Monitoring Mechanisms:** Appropriate control and monitoring mechanisms should such as periodic evaluations are critical in judging the working of a service. Such features are conspicuous by their absence in the APY scheme. Further, the APY scheme does not feature any safeguards against arbitrary changes in the policy. It does not require governments to show actuarial calculations before any changes to the design are introduced. An example of a defined benefit guaranteed return plan running into funding difficulties is the Employees' Pension Scheme (EPS). Estimates suggest that the EPS faced a shortfall of Rs.54,000 crore, and several changes in scheme design were put in place owing to these funding difficulties.

Therefore, the importance of establishing adequate control and monitoring mechanisms within the APY needs to be identified, and positive steps need to be taken in this direction.

In conclusion, the APY's role in providing a semblance of social security to some of the poorest and most vulnerable portions of the population needs to be recognised. An efficacious, simple and workable grievance redressal mechanism is an important part of this process and needs adequate attention on the part of the regulator. Complacency because the APY is a government backed scheme for the unorganised sector, should certainly not lead to a compromise on good governance standards.

[210] Ibid.
[211] Ibid n3.

V. CONCLUSION

As populations around the world age, advances in medical science lead to increased life expectancies, and simultaneously traditional modes of familial support structures break down, pensions continue to be an increasingly crucial area of financial sector reform. The policy response to these problems has mostly been incremental i.e. dealing with one crisis at a time.[212] Further, the presence of a multiplicity of agencies often leads to them operating in silos, leading to regulatory arbitrage, to the ultimate detriment of the consumers.

The Indian milieu presents some unique challenges in the context of pensions. It is predicted that the percentage of the elder population in India would reach almost 19% by 2050[213], a large part of which has not taken/is unable to take, because of a number of limiting factors, any active steps for retirement. A study of the PFRDA architecture reveals the need to focus on consumer protection and education, management of incentives for intermediaries and more financial inclusion exercises. This problem gets all the more exacerbated when it comes to the unorganised sector, which constitutes more than 80% of the Indian work force, while accounting for nearly half of India's GDP. Various unique features such as low levels of education, low productivity, lower wages, poor working conditions, uncertain and seasonal employment and lack of access to sufficient and reliable social security makes it a particularly vulnerable cohort which calls for tailored social security schemes and regulatory policies. The Government has attempted to address these problems by providing for specific social security schemes for this sector in the form of the NPS Lite/Swavalamban scheme and subsequently, the Atal Pension Yojana. However, the worryingly low rates of enrolment point to a number of problems in the design and implementation of the scheme. The treatment of distressed pension funds and the regulation of micro-pensions are examples of some critical issues which merit detailed policy deliberations.

The Indian financial sector is replete with a vast body of literature which has suggested a number of best practices for policies and regulations around pensions to imbibe. Additionally, countries such as New Zealand, Australia, Canada, United Kingdom and Chile offer many positive lessons for the design and administration of pension schemes. The pension sector, therefore, demands holistic long-term reforms which focus on providing workable, scalable, cost efficient schemes, while also addressing the pervasive inter-generational continuity of debt.

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[212] Ibid n173.

[213] '*India's Aging Population*', Paola Scommegna, Population Reference Bureau (March 2012), available at: https://www.prb.org/india-older-population/ (last accessed on 24 January 2018).

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