

# Issues in rethinking Income Security in Old Age in India

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## CONTENTS

<b>1</b>	<b>Introduction</b>	<b>2</b>
<b>2</b>	<b>Background</b>	<b>2</b>
<b>3</b>	<b>General Response to the Consultation Paper</b>	<b>6</b>
3.1	Decentralised Versus Clearinghouse . . . . .	6
3.2	Bundling with insurance . . . . .	7
3.3	Tax Treatment . . . . .	8
3.4	Annuity Providers . . . . .	9
3.5	Role for compulsion . . . . .	9
<b>4</b>	<b>Fund Managers</b>	<b>12</b>
<b>5</b>	<b>Regulatory Structure</b>	<b>13</b>
<b>6</b>	<b>Relationship With Existing Institutions</b>	<b>16</b>

## 1 INTRODUCTION

Many countries are facing similar issues with an increasing demographic problem. Governments are concerned about the future costs of acceptable welfare provision and recognise that some form of private retirement provision will be necessary. They are needing to take measures to ensure that the retired generation are given protection and that the private sector takes an appropriate role in the provision of products to help ensure adequate self-provision in retirement.

In considering these issues in an Indian context, the Dave Committee produces a consultation paper for consideration at meetings. The purpose of this paper is to offer a personal opinion on the approach taken in the United Kingdom and the lessons to be learned from the experiences of that regime. The paper begins with a brief review of the model adopted by the UK for comparison with the Indian context. It then looks at each of the key questions raised by the Committee. The layout, questions and references refer to the consultation document produced by the Committee.

As ever, there should be no question of an overseas contributor suggesting that they have particular insight for application in an Indian context. However, I am pleased to provide observations based on my consideration of the operation of pensions in the UK, the US and in Europe. Perhaps the main word of advice for the Committee is that any revised regime should seek to avoid the pitfalls revealed in other regimes. The only word of caution is that, no doubt, those in other regimes sought to do the same thing! It is essential that Government and the regulator(s) should be prepared to act as soon as any problems are identified

## 2 BACKGROUND

At the outset, we need to have a common understanding of what we are trying to deliver in the form of improved pension provision. Before embarking on the detail, it may be appropriate to start by addressing what the author believes are the key features of a pension. Definitions across the world are not totally consistent in some countries the terms savings and pensions may be used interchangeably.

In a UK context essential elements of a pension include the following:

- a mechanism for saving for old age,
- a fund built up whilst working through to retirement when it is made available to provide an income throughout that retirement,

- certainty that that income will last until death, without a significant loss in value,
- income that passes to a spouse (possibly reduced) on death of the pensioner, and
- a device that can be used as a worker changes job and, for example, moves from employment to self-employment, and vice versa.

It must be recognised, however, that other definitions exist. Some regimes appear to design pensions that cease at retirement! They only produce a lump sum; they also allow *leakage* from the pension fund prior to retirement. Pensions in the United States are a good example of such a definition. There may be parallels here for India.

The consultation paper addresses issues common to many other developed pensions systems. Indeed, the UK Government is currently tackling the problem of reaching those within both the self-employed and low-income categories who should be expected to provide for themselves without significant State support. As in India, the Governments role is to establish a regulated regime which provides adequate incentive and security to foster self-help.

Unlike India, the UK already has a well-established State welfare system although this may encourage consumption on the assumption that the State will bale out the feckless. Pensions in the UK are built on a framework of partnership between private pensions under the second and third pillars (occupational and personal pensions), alongside the State first pillar. A voluntary regime of private pensions has grown up over the last forty years through a combination of large standalone self-administered pension schemes and insured occupational and personal pensions.

Looking at the UK model generally, the key features are:

- partnership between the State and the private sector,
- a compulsory flat rate basic State pension plus an earnings related element, with an underlying income guarantee for those on low life-time earnings,
- a large voluntary occupational element, encouraged by tax relief on contributions and investment earnings (although taxed as income when paid), sponsored and partly administered by employers, and
- a voluntary personal pensions market, built on the facility to contract out of the earnings related element of the State pension.

A recent survey showed that about 50% of pensioners income currently comes from the State. Ignoring earnings and other investment income, Government figures show that the State still pays 60% of all pensions, although they have an ambition over the next 50 years to reduce that proportion to

40%. Although it is always difficult to calculate and analyse pension liabilities, it is estimated that, in the UK, State pension liabilities represent approximately 55% of the total. The remaining 45% are split between personal pensions ( 10%), defined benefit occupational pensions ( 30%) and defined contribution occupational pensions ( 5%).

The lessons to be learned from overseas models are:

- pre-funded private provision removes some (but not all) of the economic pressures of a declining workforce,
- the need to think long term and to plan in advance, taking the necessary steps early to ensure that the cost of State provision is both sustainable and affordable,
- try to build an all-party consensus to avoid disruptive changes to pension policy on a change of Government,
- use industry experts to provide a measure of independent scrutiny of any suggested changes and to de-politicise both the process and the outcome,
- people need confidence in future pension provision, so act when things are going wrong (be that the lack of sustainability of the first pillar, the lack of security of the second pillar, or the problems of poor advice in relation to the third pillar),
- build partnership to encourage best-practice and efficiency rather than competition between the different regimes,
- use a combination of tax relief and incentives alongside an appropriate level of compulsion,
- use an appropriate regulatory regime to build in the necessary safeguards without adding unnecessary cost or confusion,
- the need to include the self-employed within the overall regime, and
- the need to improve understanding by a combination of simpler pensions, better education and relevant disclosure.

The UK Government now wants to extend pension provision to those who could afford to provide for themselves, but who choose not to. The magnitude of the task in the UK is much smaller than in India. The UK Government is only expecting to extend the pension system to the outstanding 6 million of the population yet to be reached, of whom only 3 million are self-employed, (within a working population of about 28 million).

The UK solution (referred to as *Stakeholder pensions*) is a system of individual private pension accounts, operated on a defined contribution basis, with a maximum permitted charge on a fund-related basis, and distributed through groups with only limited advice. There will be compulsory access to such a pension, with all employers (irrespective of the size of the firm) being compelled, on request from the individual, to make a deduction from

salary for onward transmission to the provider. But there will be no compulsory employer contribution. In the long run we anticipate the introduction of compulsion on individuals to contribute, but the Government sees the establishment of a secure well-regulated scheme as its first priority.

Similarly in an Indian context, an individual-centric approach, some local grouping of contributions, collection and administration may be necessary. It may be that such grouping is what makes the difference between 30-40% penetration and the 50-60% target. In the UK, we believe that grouping through employer, affinity group or locality is the way of reaching a wider audience, if we are to start without compulsion.

A difficulty in discussing the design of any new system to meet the Indian objective is that the target market may be unclear. Commentators may come up with different proposals and observations, not because of any fundamental disagreement, but because they have in mind a fundamentally different objective. In itself, this implies that there may not be a single solution and, indeed, that there cannot be one single solution for what is such a large and complicated problem for India.

The Indian Government would, undoubtedly, like to facilitate the build-up of retirement benefit for those people above the subsistence level during their working lifetime who will fall into poverty in retirement. This is broadly the same target as for the UK Government, although the yardstick in the UK is not so much one of subsistence but a concentration on those earning more than half national average earnings. Those below this level will be helped with increased State benefits.

We may assume that the top priority of the Indian Government would be to provide help to those below the poverty line, although the numbers here are undoubtedly daunting. The nearest we have in a UK context is that the UK Government is prepared to offer tax relief on all contributions irrespective of earnings, implying a tax credit even for those below the threshold for paying tax.

The fundamental issue is that of employment. Having money to save almost always depends on having access to employment. The UK Government has embarked on a process known as "Welfare to Work" to help ensure that, for the time being, anyone who wants to work, up to a certain age, can find employment. With increased life expectancy, Governments are reviewing the age from which State retirement benefits are available, with more and more countries moving to an age between 65 and 70.

### 3 GENERAL RESPONSE TO THE CONSULTATION PAPER

Prior to the change of Government in the UK, the Conservative Government produced proposals for a new regime based on projecting funded pensions at a real rate in excess of 6%. This was ridiculed by the then Opposition as being unrealistic – it also substantially bigger than the rates allowed for pension projections. This is relevant by way of introduction to the detailed response, because one reservation about the paper as drafted is its reliance over the long term on such high real rates of return, illustrated between 4% and 12%. The Committee needs to be satisfied that its proposals would stand the test of real rates of return in the range 2% to 4%. I suggest that the issues remain the same, although the degree of optimism would be more realistic if kept below (say) 6%.

Addressing each issue in turn

#### 3.1 Decentralised Versus Clearinghouse

##### **Question 1: Should a system of individual accounts be built in a decentralised fashion, or should a clearinghouse come about?**

Clearing house could mean either just the collection and transmission for money or a complete administration system. The issue was raised recently in the UK, to overcome the issue where an individual was forced to change their grouped personal pension on change of employment, simply because there was felt to be no mechanism to forward deductions from salary to a variety of providers. The UK conclusion was that there is a perfectly adequate bank clearing system to provide that service as it does, for example for the payment of salaries to individuals.

In the Indian context 'clearing house' is effectively being used to mean an almost complete administration system. Individual accounts offer the potential for simplicity, transparency and ownership. However, this brings the natural expectation of clear contribution and benefit statements, both current and projected. Whilst this would encourage understanding, it would also place a demanding standard on service, clarity and efficiency. This has significant systems implications for the idea of a central clearinghouse to administer such a scheme, requiring a massive system that could only be computerised. Such a level of administration in vast numbers is probably beyond current systems capacity. The cost both in Rupees and in project management may render a clearing- house prohibitive.

Deciding not to introduce a clearing house, whilst possibly limiting choice initially, should be open for banks, post-offices and insurance companies to operate local decentralised collection and servicing facilities. Common standards and principles may provide opportunity for later consolidation and greater choice. Either way, a unique identifier is necessary across either a centralised or a decentralised system; otherwise portability would be practically impossible.

A decentralised approach would also allow localised storing of small deposits and/or

pooling of contributions prior to investment. Strict rules would need to be placed on the administration and security of even small amounts. Whistle-blowing to a regulator might prevent some fraud arising from such storing. After all, fraud is often the end result of simple mal-administration.

Cost-free transfer between providers is a requirement of a decentralised system.

**Question 2: What should be the minimum funds that an individual can accrete into an individual account in one transaction at an access point?**

**Question 3: What are the minimum funds that an individual should accrete into the individual account per year?**

The UK authorities are proposing that very small amounts should be accepted. Even though Rs.60 may not seem small, it represents a totally uneconomic amount to collect, report, administer and invest. It also creates the impression that such small amounts, payable however infrequently, can produce a meaningful pension. The UK pensions industry is arguing that the minimum payment should be at least 50, and that payable regularly, otherwise the minimum should be 250 (or about 60% of the average weekly wage).

Similarly, in an Indian context, separate minima may be needed for regular and one-off contributions. At the end of every year any contribution received could be invested irrespective of size, provided an individual has only contributed to a single provider. Alternatively, the minimum Rs 100 contribution limits into the Public Provident Fund could be carried across into this regime and applied to both one-off contributions and total contributions within a year.

Whilst the question is addressing the issue of transactions, it should also be noted that, realistically, greater than minimum contributions would probably be necessary to make any appreciable difference to standard of living in retirement. In the UK, the industry has argued that it would be wrong to set a minimum contribution that creates the impression that payments at that level would provide something worthwhile.

### **3.2 Bundling with insurance**

**Question 4: Should there be an option through which individuals can earmark a fraction of all contributions into health, life or disability insurance?**

**Question 5: If so, how is this to be implemented?**

Again, this question has been raised in the UK. Historically, pension schemes have provided life insurance benefits for death before retirement. Increasingly, personal pensions have also provided protection for ongoing premiums in the case of ill-health. However, in the context of the new simplified Stakeholder pensions, the industry is suggesting that bundling insurance into pensions products build in unnecessary complication.

Insured rider benefits complicate the product and the underwriting, and may impose premiums on those who could not benefit because of the need for policy exclusions. For example, the self-employed may be excluded from disability insurance, implying that they should not be made to contribute towards this type of insurance.

In an Indian context, these forms of insurance may be accepted as socially desirable, possibly even more so than pensions, but that is a separate issue. However, since this complicates the main pensions objective, it may be advisable to avoid bundling or rider products in the early years in order to ensure that an efficient system is set up to address the core issue, namely pensions.

Separate products could be made available, using the same distribution system. However, use of the same distribution system with a commission bias will invariably lead to mis-selling (either actual or at least alleged). Perhaps if these products were bundled in at a later stage, this could be made available with a cap on the amount of contribution that could be diverted into them.

### **3.3 Tax Treatment**

#### **Question 6: What should the tax treatment of a system with individual accounts be?**

In the UK as in many countries, pension products adopt the exempt, exempt, taxed (EET) basis applied to contributions, investment return and payment respectively, as this gives the advantage of tax deferral.

In addition up to about 25% of the fund may be taken at retirement as a tax-free cash sum. Philosophically, it is doubtful whether there should be any lump sum benefit payments, especially tax-free. There is also an argument to be made that both pre-retirement hardship and retirement lump sums should be financially disadvantaged, with tax payable at a minimum of the basic rate.

Consideration is now being given to payment of net contributions, whether or not tax is paid, together with a tax credit, thus extending the reach of the scheme to a poorer (albeit not the poorest) element in society.

In all regimes, the tax treatment needs to give the required incentives and be focused towards the correct priorities. This could also encourage the re-routing of existing savings.

There is currently a debate in the UK as to whether savings products are a better buy for the poorest in society. They provide a partial tax benefit, but they do allow access to the fund on demand.

In an Indian context, the Committee should pass comment on any anomalies that need to be corrected (for example, the tax-free entry and exit on the PPF).

As regards lump sum payments, given the current treatment of provident funds, the most acceptable solution would probably be to adopt the proposal in the first report of the Dave Committee that the tax treatment for pay-out of pension benefits and provident fund benefits should be the same. Drawing this parallel, whilst lump

sums would be allowed, tax preference would only be given to a lump sum up to a certain level.

### 3.4 Annuity Providers

**Question 7: Is it safe to proceed in building a system with individual accounts, and assume that insurance reforms will yield a competitive and efficient annuity market in the years to come, when individuals would start leaving the individual account system at age 60?**

The quick answer is yes, but it will be important to ensure that only approved insurance companies are allowed to offer annuities.

Taking the UK market as an appropriate model in this case, the annuity market should be efficient; depending as it does only on expenses, mortality and investment returns, assuming the solvency of the provider is adequate.

Internationally, although there has been some criticism of lower investment returns in some markets (e.g. US, UK and Europe), this relates directly to the expectations of lower long-term rates of inflation. Because many people save insufficiently for their retirement, historically they have cheated themselves by buying level rather than inflation proofed annuities, thus leaving themselves much worse off in later old-age. With the current expectation of lower inflation, there is less scope to cheat in that way. In practice, with lower inflation, it is not possible to render oneself so much poorer in late old-age.

There are some who advocate that equity rather than bond investment should be allowed for annuity funds, but this is not a criticism of annuities as such. So-called with-profit annuities investing in equities are available in the UK market, not least from Prudential, which was one of the first companies to market them over eight years ago.

Some argue that it should not be necessary to purchase an annuity, but that it should be allowable to draw on the fund as need arises throughout retirement, known as systematic withdrawal (and known in the UK as income drawdown). Under this model, limits must be set on this to ensure that neither too much nor too little is drawn down. In the US, systems available on the Internet encourage pensioners to calculate their expectation of life and to spread their capital appropriately. Naturally this needs periodic revision. To UK eyes, this seems a haphazard approach.

### 3.5 Role for compulsion

**Question 8: Should there be an element of compulsion for some individuals to open accounts?**

**Question 9: If so, how should it be done?**

Governments need to identify their crucial role and ensure that it is both sustainable and affordable. In the UK, this involves an element of compulsion. For those earning more than over 15% of national average earnings, they are required to pay towards an earnings related pension from the State. Alternatively an equivalent payment can be made into a fund with a private provider to purchase retirement benefits.

The State can effect redistribution via a combination of compulsion and taxation to support those on low lifetime earnings. The compulsory level of pension provision must strike the right cultural balance between the long-term benefits to individuals from better income in retirement with the right of individuals to have freedom of choice in how they use their money.

As an alternative to compulsion, a mechanism needs to be made available to encourage greater voluntary personal provision. Increased public awareness and understanding of pensions are an essential ingredient. Government needs to spell out unambiguously the likely value of state pension provision in relation to future living standards. As Governments cut their support, due to pressure on resources, it is important for this to be communicated clearly. However, there are obvious political difficulties in so doing.

To avoid compulsory pension provision looking like taxation under a different name, investors like named accounts, preferably updated monthly, alongside simplicity, security of capital and individualised personal control. It may also be necessary to reduce the role of politicians in running pensions if the public are to be convinced that their clear expectation of future benefits cannot be reduced without a public outcry.

In an Indian context, the extension of compulsion may need to be gradual. Since it is only realistic to compel those who can afford to contribute to do so, probably assessed against some salary criteria. Moreover the contribution must realistically be able to be maintained. It may be easiest to address the needs of the better off first and then spread the mechanism as the systems evolve. The present coverage of employed persons in provident funds could be used. These could be converted into individual accounts or those in employment in smaller firms and not covered by the provident funds could be covered by individual accounts, as explored in question 20. The legislation could be amended to require any establishment registered under the Shops and Establishments Act, irrespective of the number of persons employed, to open individual accounts for all their employees and contribute to those accounts. A certificate from the fund managing the individual accounts should be one of the requirements for licence renewal.

Once appropriate, compulsion could be phased in. Initially it could be mandatory for employed and self-employed alike through their respective professional bodies or through their professional tax collecting machinery. But this issue would require in depth examination to ensure fair and uniform treatment.

Under a compulsory system, if non-payment is to be detected, an efficient collection and reconciliation system is necessary. This is a further argument against a centralised clearing system. Something more local should be more efficient in this respect, provided there are unique identifiers of those contributing.

The whole concept of compulsion is undone if there are easy withdrawals.

Ultimately, compulsion is the only solution, but only when it can realistically be targeted on those who can afford it, and there is an effective monitoring system. But it is better to get the system up and running first, before contemplating introducing compulsion, so that a culture of non-payment does not develop.

**Question 10: Should all accountholders be forced to contribute a minimum amount every year? What should this minimum amount be? How should it be enforced?**

This question is linked to question 6 and the extent of any tax credit. To incentivise contributions it would be possible to provide any level of rebate, be it 100% or 1000%. The current proposal in the UK is that anyone contributing to a Stakeholder pension will at least receive a tax credit equal to about 30% of the net payment even if they do not pay tax.

This issue is also linked to question 3. In India, the minimum Rs.100 contribution limits into the Public Provident Fund could be carried across into this regime and applied to both one-off contributions and total contributions within a year.

**Question 11: Should there be barriers to withdrawals, and what should those barriers be?**

In the UK there are no withdrawals other than in the event of impending death, meaning that the contributor has less than one year to live.

Even lump sum payments on retirement are not allowed for those simply providing an alternative to the State pension.

As noted in connection with questions 8 and 9 there is a link to whether there is compulsion, which is undone by easy withdrawal. Similarly, as noted in connection with question 6, a tax charge should be imposed if there were any tax credit offered on contributions.

If hardship withdrawals were allowed, it might be appropriate to operate the approach proposed by the Pension Group constituted by the Confederation of Indian Industries, that repayment should be required within 48 months and that interest should be charged at a rate 2-2% above base.

Philosophically, consideration should be given to removing the access to lump sums at retirement. It is possible that lump sums at retirement might bring an expectation of an early inheritance for the younger generation.

**Question 12: Upon exit, should there be mandatory annuitisation of part or all of the accumulated assets?**

In the UK, the answer to this question is, yes, unless the fund is above a certain level. The alternative to annuitisation should not be cash unless the fund is below a level which makes periodic payments uneconomic. Otherwise the alternative in the UK to annuitisation is known as *income drawdown* (and in India as *systematic withdrawal*), as described in answer to question 7. In the UK, this is only felt to be appropriate for funds in excess of \$100,000. At present, the average pension fund

at retirement is nearer \$10,000. Even so, an annuity is compulsory by the age of 75.

In Ireland a system has recently formally been introduced which avoids the need ever to buy an annuity, irrespective of age, provided the fund is large enough (greater than \$50,000).

The type of annuity should also be considered. I would suggest that it should allow for some degree of inflation. In the UK, this would either be price-inflation linked (provided adequate gilts are available to guarantee matching of the assets and liabilities by an insurance company), or perhaps more suitable in an Indian environment, fixed 5% per annum escalation. Moreover, spouses benefit (spouse at retirement not spouse at death), should be offered (and possibly dependants benefits, subject to underwriting).

#### 4 FUND MANAGERS

##### **Question 13: What should the investment guidelines be?**

In the UK, pension schemes have developed investment regulation under the concept of so-called *prudent man* rules. Being qualitative in nature, prudent man rules are open to differences in interpretation both between and within countries, which makes agreement on implementing regulation more difficult.

In practice there are:

- lists of approved categories of financial assets that can be held, which are considered to have acceptable levels of default or liquidity risk,
- maximum percentages of total investments that can be held in a given category of investment, especially those deemed to have higher levels of default or liquidity risk,
- a maximum limit on the proportion of total investments that can be held in a single investment, e.g. the shares of one company, or a single property,
- a minimum percentage of assets that must be invested in the same currency as that in which the liabilities will be paid, to protect against the risk that the currency in which the investments are held may have depreciated by the time the liabilities become due for payment,
- limited use of derivatives appropriate to the hedging of investment risks, both in respect of hedging against a rising stock or bond market when investing new funds, or by hedging against falling market prices for assets already held, and
- a limit on the level of self-investment (i.e. investment in the sponsoring company), thereby reducing the risk for members of losing both their livelihood and their pension entitlements if their employer becomes insolvent.

When applied to India, this is a particularly big question, since separate consideration needs to be given to the most efficient mechanism to direct the invested resources for the benefit of India. For example, whilst some may call for significant levels of overseas investment, that may not benefit growth in India. It would be no surprise, initially, to see a requirement that all local liabilities should be covered by local assets. Similar principles could be applied to localising assets even further, to a region.

Otherwise the approach should take a long-term outlook. Although equity investment brings the problems of volatility, it may not be understood that the peaks and troughs need to be ridden out.

Doubts about security are best met by being able to show that at least 100% of contributions are still in the fund after a year. Research in the equivalent UK market suggests that a capital guarantee is better than an assured return, although this may be best achieved by a *with-profits* approach rather than through the purchase of derivatives.

**Question 14: What should the entry barriers into pension fund management be? If the number is to be restricted, how should pension fund managers be selected?**

The UK may perhaps be regarded as one of the most open markets in the world. The consequence of this is that the main entry barrier is the severe competition. By way of example, the proposal is that the maximum charge under Stakeholder pensions should be limited to 1% of annual funds under management.

In general, new players need a track record, a history of performance in the relevant investment markets, quality of service, local certification and adequate capital reserves.

In India, I suggest that the regime needs to be able to attract variety and innovation, although an appropriate risk index needs to be developed.

SEBI (in India) and the FSA (in the UK) can probably provide guidance on regulation and the appropriate stages in de-selection.

## 5 REGULATORY STRUCTURE

**Question 15: What shape should IPA take?**

The form of the regulation is much more relevant than which agency is operating it. There also needs to be a general acceptance that the form that regulation is agreed and understood.

It could learn from other regulators in India (e.g. SEBI and IRA) and in the UK (e.g. OPRA - the Occupational Pensions Regulatory Authority and IMRO - the Investment Management Regulatory Organisation).

Regulation needs to be proactive, not just reactive.

The regulatory regime should allow for whistle-blowing, offering legal protection to non-malicious reporting of potential irregularities. This should help prevent fraud, which often results from an inability to correct minor mal-administration which then becomes progressively more serious.

The regulatory regime needs to be relevant to the local market, but by way of indication, in the UK, OPRA has the following responsibilities:

- Scheme trusteeship.
- Minimum funding requirements.
- Modifications to trust deeds and scheme rules in appropriate circumstances.
- Wind-up schemes appropriate and breaches of requirements for surplus or excess assets on winding up.
- Transfer payments.
- Breach of main pension scheme regulations.
- Contravention of scheme requirements.
- Contravention of the requirement to pay the regulators levy.
- OPRA also administers a Pension Schemes Registry. Under those powers, OPRA as registrar:
  - compiles and maintains a statutory register of information about occupational and personal schemes,
  - provides registry information to scheme members and other appropriate bodies, and
  - collects the general levy, and collects and accounts for the compensation levy on behalf of the Pension Compensation Board.

As regulator, OPRA has powers:

- to appoint, suspend, prohibit or disqualify trustees,
- to issue enforceable directions in certain circumstances,
- to wind up schemes,
- to require information,
- to enter, at all reasonable times, any premises liable for inspection,
- to obtain a warrant to enable OPRA inspectors to enter and search premises, copy documents, take possession of documents, require any named person to provide an explanation of documents, require any named person to state where certain documents may be found,
- to institute legal proceedings against and impose civil penalties on any person refusing to produce a document (under section 98) or refusing to allow investigation to take place (under section 99) and to publish any reports of investigations,
- to exchange information with designated bodies, and
- to institute legal proceedings for failure to register or failure to pay the levies,

OPRA obtains its funding from the Department of Social Security to enable it to undertake its duties and responsibilities and to achieve the objectives agreed during the annual planning cycle and the Public Expenditure Survey. The full expenditure costs of OPRA are recovered through a levy on occupational pension schemes (the general levy) the rate of which is set by the Secretary of State for Social Security.

The Secretary of State for Social Security is accountable to Parliament for OPRA's activities, and needs to be satisfied that OPRA's activities are consistent with its functions under the Pensions Act, and with the Government's general aims. OPRA is required to provide the Secretary of State with an annual report of its activities for the preceding twelve-month period, which is laid before each House of Parliament. Parliament also exercises oversight and scrutiny of OPRA through the Comptroller and Auditor General, who has responsibility for auditing OPRA's accounts. Copies of the Comptroller and Auditor General's statements and his report on them are also laid before each House. OPRA is subject to the jurisdiction of the Parliamentary Commissioner for Administration.

The UK Parliament means OPRA to be reactive, relying heavily on the industry, especially trustees and professional advisers, to make the new system work and to report to them when things went wrong. OPRA has established a help desk, and work closely with the professional bodies and trade associations to help implement essentially what is a change of culture that happens to be enshrined in legislation.

OPRA's main lines of communication to help the industry and complainants are:

- Formal guidance notes directed at the industry, including professional advisers.
- A hotline for reporting, sometimes anonymously, misdeeds.
- A wide range of public information leaflets and booklets.

**Question 16: What is the potential for fraud in a system with individual accounts, and how can it be forestalled? What does our experience with fraud in banking and mutual funds tell us about this new area?**

UK experience is that fraud is most likely on transmission of contributions and benefits, which will in the majority of cases be via a third party.

As indicated in answer to question 15, it is often mal-administration that leads to fraud. The biggest current concern of the UK pensions regulator (OPRA) is over the non-payment of contributions deducted from salaries by employers - that delay is normally as a result of mal-administration. They want the whistle to be blown in order that they may correct the situation before it progresses to fraud. However, mal-administration does not only apply to the payment of pension contributions, it almost certainly also applies to the payment of taxes and social security contributions for just the same reasons.

It will be necessary to ensure that contribution schedules are passed from fund manager to the client. Regular statements to the ultimate pensioner are likely to help minimise fraud.

From the outset, collection must be as efficient as possible.

**Question 17: Should the IPA regulate EPFO?**

Yes. There is no reason why the IPA should not regulate the EPFO, especially since there are reportedly some concerns regarding the administration of this fund.

The EPFO should not become the regulator.

**Question 18: How should IPA harness the skills and procedures for regulation of fund management that exist today in SEBI?**

See question 15.

6 RELATIONSHIP WITH EXISTING INSTITUTIONS

**Question 19: Should individuals have portability for moving their provident fund balances into the new individual account?**

Yes. Portability will allow funds to build up in a combined fund without leaving potentially small funds scattered in different schemes.

Experience from both the UK and the US suggests that schemes may need to be told that fair transfer values should be given. Without necessarily setting a statutory basis for transfers, it is important that those who leave a scheme early do not subsidise those who remain.

It is important to ensure that the tax rules are the same for individual accounts and provident fund balances, if necessary changing the provident fund rules.

**Question 20: Should smaller establishments be making mandatory provident fund contributions into the new individual accounts?**

Yes. Experience in the UK suggests there should be no lower limit to the size of company. This avoids any disincentive to allow a company to grow. It is possible that the removal of any limit would encourage small companies to grow in favour of an economy with such a large proportion of self-employed and contract workers.

Both UK and US experience is that, even for individual accounts without an employer contribution, deduction from salary is the most efficient method of payment.

The legislation in India could be amended to require any establishment registered under the Shops and Establishments Act, irrespective of the number of persons employed, to open individual accounts for all their employees and contribute to those accounts. A certificate from the fund managing the individual accounts should be one of the requirements for licence renewal.

**Question 21: What should the future of PPF be?**

There are potential difficulties if similar products are subject to different tax regimes. In an efficient market, funds will move to those products that provide maximum

benefit. Ultimately, they should be amended and brought under the same tax regime.

PPF should be an integral part of the solution. It represents the base from which individual accounts would grow.

**Question 22: For new entrants into the labour force, should government or defence employees be making contributions into individual accounts instead of drawing defined benefit pensions?**

Where this represents the funding of otherwise unfunded liabilities, most overseas Governments have found such a proposition too expensive.

**Question 23: What can be done to maximise the number of individuals who choose to open accounts?**

There are a number of lessons that from this trend overseas:

- Take it gradually, building towards an ultimate picture of what the regime should provide. It cannot be achieved in one large step. There is unlikely to be a single model suitable across the whole of retirement provision.
- Switch provident fund balances into a single fund, make contributions mandatory in all establishments, and switch new entrants into individual accounts, as outlined in the answers to questions 19 to 22
- Open up the market by allowing local distribution, rather than waiting for a massive centralised clearing house.
- Provide good quality of service (for example benefit statements).
- Ensure good regulation.
- Ultimately, introduce targeted compulsion. It needs to be targeted at those who can realistically afford to pay.
- Focus attention on the need for full employment.

**Question 24: What is the role for NGOs as pooling agencies?**

Whilst they have a significant role to play in local distribution, they should not be allowed to become local monopolies.

**Question 25: What can be done to improve knowledge about financial planning for old age among crores of individuals?**

It may be worth considering this as a several stage process differentiating awareness, education, information, advice and selling. In most, if not all, countries there is the problem that financial products may be too complicated for the general level of literacy and numeracy. The need to account for inflation takes most products outside the field of confidence of most people. In such cases, it is important there is general confidence in those giving the advice.

Knowledge, interest, education and understanding can be improved by introducing standards seen in other pension regimes across the world:

- Simple products.
- Individual accounts.
- Regular contribution and benefit statements.
- Self-help groups for discussion.
- Training and competence tests for advisers.