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Group superannuation schemes in India

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1 Introduction

A large part of the occupational retirement benefits in India are covered by Employees' Provident Funds and Miscellaneous Provisions Act 1952. The two main schemes under the Act are Employees' Provident Fund and Employees Pension Scheme. Apart from these mandatory schemes the employers can also provide for additional retirement benefits to their employees by subscribing to group superannuation schemes. These benefits are in the form of superannuation schemes, wherein the employer contributes towards the employees and at the time of retirement, the employee is paid pension. Inspite of the fact that it ts not mandatory for the employer to purchase a group superannuation scheme an employer has incentives to opt for a group superannuation scheme because such a scheme not only enables the employees to lead a better life after retirement, it provides a number of benefits to the employer as well. It serves as a valuable tool to enhance the image of a company, attract talented recruits and retain quality staff. Typically employers either set up trust funds to manage these schemes or buy policies from insurance firms. There is no one entity that regulates superannuation plans offered by employers and hence there is no data about how many such plans exist. One can only get information about plans that are sold by insurance companies. Accordingly the thrust of the paper is on these plans. Section 2 talks about the ways in which these plans can be offered to employers. Section 3 talks about the benefits of the schemes. Section 4 talks about the market for superannuation schemes. Section 5 talks about the regulatory lacuna with respect to the superannuation schemes. Section 6 concludes.

2 Constitution of superannuation schemes

The group superannuation schemes are voluntary in nature. It is completely the employer's discretion whether he wants to opt for a superannuation scheme. The employer also chooses the class/classes of employees to whom he wishes to extend the provision. He can choose the class of employees on the basis of salary, designation, etc. However once the categories are decided the provision extends to all the employees falling in those categories. An employee can choose not to be a part of the scheme. In this case the employer contributes an equivalent amount to the employee's salary. The employees can also make contributions to the superannuation fund. In this case it will be called Contributory Pension Fund Scheme. The employer can contribute either a fixed amount to each employee's account or a certain proportion of the employee's salary. The contributions can be made annually, semi-annually, quarterly or on a monthly basis. Separate accounts are maintained for each employee. These accounts reflect the total accumulation in each person's account.

A company can offer a group superannuation scheme in two ways.

- Through the constitution of a trust fund.
- Buying a superannuation scheme from a life insurance company

In either case the company has to follow the three steps listed below.

1. Appoint trustees to administer the scheme , draft the trust deed and pass it to establish an irrevocable trust.
2. The Board of Directors of the company has to pass the resolution for opting for a particular scheme.
3. An application has to be filed with the Commissioner of Income Tax (CIT) for approval of the scheme

In case the company decides to go via the trust fund route, it will then have to appoint fund managers for the investment purposes. Once the permission has been granted, the employer would then remit the monthly contributions to the fund who would manage the contributions. In the case of buying a policy from an insurance company, the superannuation trust would then have to do the following

1. Forward the proposal form signed by trustees to the life insurance company.
2. Supply data about age of employees along with the contribution to the life insurance company.

Currently there are fourteen life insurance companies in India registered with the Insurance Regulation and Development Authority (IRDA) out of which eight offer group superannuation schemes. These nine companies are

- Life Insurance Corporation of India.
- ICICI Prudential Life insurance company Limited.
- TATA AIG Life Insurance Company Limited.
- MAX New York Life Insurance Company Limited.
- Bajaj Allianz Life Insurance Company Limited.
- AMP Sanmar Assurance Company Limited.
- Kotak Mahindra Old Mutual Life Company Limited.

- Birla Sun Life Insurance Company Limited.
- Aviva Life Insurance Company India Private Limited.

These companies provide a wide variety of schemes. An employer can subscribe to any scheme of their choice. Most insurance companies are willing to customise the scheme so as to make it suitable for the employer and the employees.

The appointment of trustees to administer the scheme is one of the defining features of the scheme. The rationale behind the administration of the scheme through trustees is to ensure that the employees' interests are safeguarded and the benefits that accrue to them are not affected by the employer's financial position. The trustees are responsible for collecting the contributions from the employer and from the employees (in case of a contributory pension fund), buying the group superannuation from a life insurance company, paying the benefits to the employees once they separate from the company and look after the accounts. The trustees can use their discretionary powers for the settlement of benefits in unusual circumstances. The trustees should maintain all regulatory requirements prescribed under the Income Tax Rules 1961.

3 Benefits

3.1 Benefits after retirement

On retirement the employee is allowed to take one third of the accumulation in his account as commutation. The balance in the corpus is used to purchase an annuity. Apart from LIC all other life insurance companies allow its customers to purchase annuity from any annuity provider. The annuity rates are the rate prevailing in the market for the chosen annuity at the time of the employee's retirement Once the annuity rate is decided it remains unaffected by market fluctuations in the annuity rates.

3.2 Tax benefits

If the group superannuation scheme purchased by the employer is approved by Commissioner of Income Tax (CIT) then both employer and employees are eligible to get tax benefits. Schedule 4 of the Income Tax Act lists the conditions that are essential for the superannuation funds to qualify for tax benefits. These conditions are as follows;

- The fund should be a fund established under an irrevocable trust.
- The fund should belong to the employees of an organization carrying on business in India and at least 90% of the employees should be employed in India.
- The sole purpose of the fund should be to provide annuities for the employees in the organisation.
- The employer should contribute to the fund.
- All pensions and annuities should be payable in India

3.2.1 Tax benefits to the employer

The annual contributions by the employer are treated as deductible business expense as per Section 36(1)(iv) of the Income Tax Act.. However the maximum amount that is tax deductible is 27% of the employees' salary. This 27% includes the contribution made towards the mandatory EPF & EPS.

3.2.2 Tax benefits to employees

The employees get the following benefits

- Contribution by employer is not treated as a perquisite in the hands of the employees.as per Section 17(2)(vi)
- Interest income is tax free
- Commuted value upto 1/3rd on retirement is tax free as per Section 10(10A)(II) of the Income Tax Act.
- Benefits payable in case of death are exempt as per Section 10(13) of the Income tax Act
- Employees' contribution if any qualify for tax deduction under Section 88 of the IT Act.

3.3 Option on changing employer

If an employee moves from on job to another he has the following three options

- He can get the amount transferred to the new employer's superannuation scheme if the rules of both the schemes allow.

- The employee can opt for getting the pension from the normal date of retirement. In this case the old employer would cease to contribute to the scheme but interest would accrue on the accumulated amount.
- He can opt for an immediate annuity with optional commutation . In this case the benefits are taxable.

3.4 Life insurance policy

Most life insurance companies offer the employer the option of purchasing a group life insurance policy along with the group superannuation policy . In this case a lesser premium needs to be paid for the group life insurance policy. If the group life insurance policy is purchased a lump sum is paid to the beneficiary in case the employee dies while in service. This is apart from the annuity that the beneficiary receives

3.5 Other Benefits

The insurance companies also provide advice regarding investment options and annuities. The members are regularly given statement showing the value of their accumulation. Some companies also organize meetings with the employer.

3.6 Loans

The life insurance companies are not allowed to make any loans to members of the group superannuation scheme

4 Market for superannuation

The LIC is by far the largest player in the superannuation industry and its coverage has been showing regular increase. However after the private players were allowed to enter the insurance sector in the year 2001, they have been steadily expanding their business. Max New York and Bajaj Allianz have recently received approval for launching the scheme. Together these companies have the capability to offer wide range of products.

The LIC offers a non unit linked scheme. On retirement a subscriber can choose one out of five pension schemes offered by LIC. They are

- Life pension ceasing at death.
- Life pension with return of capital and group pension terminal bonus on death.
- Life pension guaranteed for 5, 10, 15. 20 years and life thereafter.
- Joint life pension payable on the last survivor and the spouse.
- Joint life pension payable to the last survivor of the employee and spouse with return of capital on the death of the last survivor.

TATA AIG was the first private company to receive approval to enter into pension business in 2001. It was also the first private company to launch a group superannuation scheme. It offered a non unit linked product. With the recent approval from IRDA to launch unit linked products TATA AIG is currently the only company to offer both unit linked and non linked group superannuation schemes.

All other life insurance companies offer unit linked schemes. In such schemes the contributions are converted into number of units based on the prevailing Net Asset Value of the unit. At the time of retirement, the units in the individuals account would be redeemed at the prevailing NAV to calculate the accumulation.

4.1 Investment pattern

Investment of the superannuation funds has to be done by the insurance company subject to the IRDA investment guidelines 2001. The investment pattern for the non linked products are as follows 1)Not less than 20% in government securities 2)not less than 40% in government or approved securities (including (1) above) 3)not less than 60% in approved investments

In case of linked pension products the investment would be according to the objectives of the fund subject to the conditions that 1)The entire fund cannot be invested in equities 2)The investment in other than approved securities should not exceed 25

Table 1 give the upper limit for investment in various funds of the some of the companies. [1]

[1] Table 1 shows the limits on investment currently applicable and are subject to changes.

Table 1: Maximum limits for investments of superannuation funds

Company and their funds	Money Market Instruments	Securities issued or guaranteed by central government	Debt securities	Infrastructure bonds	Equity
Kotak Mahindra Old Mutual Life Company Limited					
Money Market Fund	100				
Gilt Fund	20	100			
Bond Funds	20	75	100		
Balanced Fund	20	70	0	0	60
Birla Sun Life Insurance Company Limited					
Gilt Funds	20	100			
Bond Fund	20	0	100		
Fixed securities	70	90	75		
Secure Fund	50	90	30	25	20
Sable Funds	35	80	30	25	35
Growth Fund	20	55	30	25	
Bajaj Allianz Life Insurance Company Limited					
Secure Gain	20	90	30	25	20
Stable Gain	20	80	40	25	35
Accelerated gain	20	50	50	25	50

Source: Websites of the companies listed above.

4.2 Investment management charges

The insurance companies levy certain charges in return for the services they render. These charges constitute the costs of fund management and the profits to insurance companies from rendering such services. In case of LIC the only charge is the difference in the interest earned on investment and the interest paid. The charges in case of other insurance companies are shown in Table 2.

Table 2: Charges of insurance firms

Companies	As % of funds under management
TATA AIG Life Insurance Company Limited	
Liquid fund	0.9% p a
Income Fund	1% p a
Equity Fund	1.75% p a
Allianz Bajaj Life Insurance Company Limited	
Upto 2 crores	1.2% p a
2 to 5 crores	1.0% p a
Above 5 crores	0.8% p a
Kotak Mahindra Old Mutual Life Company Limited	
Money market fund	0.6% p a
Gilt fund	1.0% p a
Bond fund	1.2% p a
Balanced fund	1.3% p a
AMP Sanmar Assurance Company Limited	
Group capital secure fund	1/12 of 1.5% of fund balance
Group balanced fund	1/12 0f 1.5% of fund balance
Group growth fund	1/12 of 1.75% of fund balance

Source: Websites of the companies listed above.

4.3 Options to switch

The companies allow individuals to switch between investment options. A person for example may invest in growth fund which carries a high risk as well as a high return and may later shift to a less risky balanced fund The companies allow a given number of free switches. If the number of switches exceed this number then the individual or the trustee as the case may be has to pay charges.

Table 3: Group superannuation schemes-new business during the year

Year	No. of new schemes	No. of new lives covered (under both new and existing schemes)
1989-90	271	95,410
1990-91	275	17,201
1991-92	306	22,587
1992-93	249	34,709
1993-94	273	42,182
1994-95	328	40,706
1995-96	353	88,076
1996-97	373	134,948
1997-98	393	42,544
1998-99	369	62,494
1999-00	323	75,766
2000-01	408	98,603
2001-02	427	61,949
2002-03	305	1,14,874

Source: LIC annual reports.

4.4 Performance

The performance of Life Insurance Corporation of India gives an insight into the growing demand for group superannuation products. During the year 2002-2003 305 new schemes covering 1,08,759 lives were finalised. In the year 2001-2002 427 schemes covering 61,949 lives were finalised. At the end of the year 2002-2003 LIC had a total of 6,461 schemes in force covering 10.86 lakh members. In the past year Rs.5,111.5 was earned as premium from group superannuation schemes. and annuities worth Rs.1,488.98 crores were paid out. Table 3 shows the total number of new schemes launched each year and the number of new lives covered while Table 4 shows the number of schemes and members at the end of each year. The coverage of the group superannuation schemes has shown a continuous increase in terms of the number of lives covered. With the exception of certain years, the number of new schemes offered each year has shown a rising trend. The number of new lives covered has shown a fluctuating trend, rising sharply in some years

Table 4: Business in progress

Year	Number of schemes	Total number of members (in lakhs)
1989-90	2,405	2.32
1990-91	2,600	2.43
1991-92	2,806	2.54
1992-93	3,040	2.69
1993-94	3,314	3.14
1994-95	3,642	3.54
1995-96	3,977	4.19
1996-97	4,349	5.54
1997-98	4,719	6.71
1998-99	4,963	7.54
1999-00	5,246	8.09
2000-01	5,753	8.84
2001-02	6,109	9.80
2002-03	6,461	10.86

Source: LIC annual reports

while falling during some years and growing steadily during the rest. Most of the new lives covered each year are accounted for by lives covered under new schemes.

5 Regulation of superannuation funds

The central problem in the superannuation market is that there is no regulatory authority that oversees the functioning of the superannuation trust funds. As a result of this, frauds or mismanagement of funds goes unnoticed and unsuspecting plan members often lose their money. The setting of the PFRDA to regulate the new pensions scheme, should also lead to the inclusion of the superannuation funds into its mandate.

6 Conclusion

The superannuation schemes can play an important role in providing better lives to people after retirement provided the schemes are administered prudently. The trustees have an important role to play in this respect since they have the responsibility of protecting employees' interest. Even more important is the role of IRDA .The should regulate the insurance companies in a manner so as to ensure that members of the schemes can enjoy an easier and more secure life after retirement.