

Developing Micropensions in India: Issues and Challenges

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Abstract

Micropensions refer to long term savings, by relatively low income, informal sector workers, with the objective of obtaining income security during old age. While the microfinance industry has shown rapid growth, micropensions are still in the early stages of development.

A micropension plan is typically designed as a defined contribution plan providing for small value, frequent contributions which are collected at a place convenient to the member. The plan needs to address longevity, investment and inflation risks specifically in the context of low income members.

Demographic trends underline the need for micropensions in India. The possibility of using microfinance institutions (MFIs) as a channel for organizing micropensions is analyzed. Case studies of two micropension plans launched recently in India are discussed.

The paper concludes that with appropriate regulation and more robust risk sharing arrangements, there is potential for micropensions to play a useful role as an integral component of India's social security system.

I. Introduction

Micropensions refer to long term savings, by relatively low income, informal sector workers, with the objective of obtaining income security during old age. Though informal sector workers may not “retire” in the formal sense like employees in the organized sector, they need to provide for the reduction in income earning capacity during old age, particularly due to ill health. Micropensions therefore aim to provide a flow of income to coincide with this decline in income.

A number of studies have described cases illustrating that the poor understand the value of saving for retirement (Todd, 1996; Rutherford, 2008). Even when safe savings avenues are not available, they sometimes borrow so as to acquire assets which they hope will provide security during old age. There are also instances when the poor are found to be willing to accept negative interest rates from deposit collectors for the service of collecting their small deposits over a period of time and returning it to them as a lump sum in a later period.

As the poor typically have multiple demands on their scarce resources, savings which are targeted in nature or are specifically aimed at an event have been found to motivate them to save more. Field studies indicate that there is a preference for small, frequent contributions that are collected at their doorstep. At times, some features of illiquidity

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that discourage withdrawal also help them save more (Karlan, 2004). There is therefore a need for providing appropriately designed savings products for this segment of the population for various purposes, including retirement.

The need for financial services by low income groups is evidenced by the rapid growth of the global microfinance industry. At the end of 2007, worldwide, around 3552 micro finance institutions reported reaching 154 million individuals¹ while in 1997, only 618 institutions reported reaching 13 million individuals. These are impressive figures even after taking into account increased reporting as a contributory factor.

Low income groups like the rest of the population, have diverse financial goals such as financial leverage, capital appreciation, capital preservation and risk management which call for a range of financial services including microcredit, micro savings, microinsurance, remittance products and micropensions. From the social view point as well, it is desirable that the minimal resources of these groups be managed wisely by use of appropriate instruments.

While availability and use of some microfinance products such as microcredit and microinsurance has shown rapid growth, a survey of 57 leading regulated microfinance institutions (MFIs) by WWB GNBI (Women's World Banking Global Network for Banking Innovation) in 2001 shows that only 9% indicated that they offered products

¹ The Microcredit Summit State of the Campaign Report, 2009

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geared to improving their members' old age security. Moreover, none of these institutions had products that used the principle of pooled resources for multi asset investments.

The few institutions which offered pension style products primarily offered long term savings products, life insurance schemes and products that were hybrids between savings and pensions. All of them enjoyed high profitability and high client satisfaction indicative of the potential for micropension products (WWB, 2003). From the social security perspective though, the products could have been improved by adding more pension features such as pooling of capital, restricting withdrawals and having formal pay-out structures.

In 2002, Bangladesh's Grameen Bank, one of the pioneer MFIs, launched Grameen Pension Savings (GPS). This product (not included in the WWB study mentioned above) was essentially a contractual savings product, obligatory for members who took larger loans (8000 taka or more).

The product found wide acceptance partially due to its mandatory nature for large Grameen Bank borrowers, but also because of the reputation of the Grameen Bank as a depository institution and the high interest rate (12% per year for the ten-year term) offered on savings (Rutherford, 2005). The features of the product are more similar to a long term contractual savings product rather than a pension product, but may be viewed as a useful first step before offering full-fledged pension products.

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True micropensions need to essentially provide at low transaction costs, a means for asset accumulation, in order to provide income security during old age by pooling of risks and diversification.

This paper examines issues relating to micropensions in India and argues that they can play a useful role in promoting social security if they are brought into the mainstream of the financial system.

The paper is organized as follows: Section II describes the need for micropensions in the Indian context. Issues in designing micropensions are reviewed in section III. A discussion on using micro finance institutions (MFIs) as channels through which micropensions can be offered is provided in Section IV. This is followed by a review of two case studies of micropensions in India in Section V. The final section provides concluding observations.

II. Need for Micropensions in India

India is experiencing a demographic transition leading to lower total fertility rate, increased life expectancy and consequent increase in the proportion of the aged in the population. The share of the elderly (or persons aged 65 years and above) in India's population is expected to rise from 4.6% in 2000 to 9% in 2030. In absolute terms, the number of those above the age of 60 will rise from 87.5 million in 2005 to 100.8 million in 2010. By 2030 this number is projected to be around 200 million, which will increase

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further to 330 million by 2050. This suggests that lack of pension coverage will affect more persons than ever before. The share of elderly as a proportion of working age population namely the old age dependency ratio will also increase.

Increased life expectancy means that each elderly person will require support for a longer period. In 2005, an Indian man reaching 60 years of age can on an average be expected to live for another 17 years and an average woman 18 years. This is expected to increase. Uncertainty about the pace of increase has major implications for annuity markets and for health insurance.

Both the level and the pace of ageing are likely to provide significant challenges as even in 2030, India's per capita income will be relatively low. As women are increasingly living longer than men; greater feminization of the adult population is taking place (Liebig and Rajan, 2003). Providing secure and sustainable retirement income therefore ranks high in the social priorities.

Presently, only about a fifth of India's 460 million strong labor force and about a quarter of its 90 million elderly benefit from at least one of the components of India's social security system².

New Pension Scheme

² Annexure 1 provides an overview of India's social security system

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In April 2009, a universal voluntary pension scheme called the New Pension Scheme (NPS) is to be launched by the Pension Fund Regulatory and Development Authority (PFRDA). This scheme will be open to all citizens and can be accessed through 23 point of presence entities which includes licensed banks, insurance companies, mutual funds and financial distribution firms. The National Security Depository Limited (NSDL) has been appointed as the central record keeping agency (CRA) and will be responsible for maintenance of individual pension records. The investment of the proceeds is to be done by six approved fund managers, three from the public sector and three from the private sector. The scheme offers flexibility to members on the choice of fund manager as well as the nature of the investment plan.

The costs of the scheme have been kept at nominal levels to encourage membership. At the time of membership, a joining fee of Rs.350 and a registration fee of Rs.40 is payable. An individual account is created and a permanent retirement account number (PRAN) is assigned to each member. Thereafter a Rs. 20 transaction charge has to be paid each time a fresh contribution is made to the account. The fund management fees, which were arrived at on the basis of competitive bidding is 0.0009%, which is very low as compared to the fees charged by most mutual funds who charge up to 1.75% per year.

The features of Government backing and low cost, make extension of this scheme to micropensions desirable. However, a modified version of the scheme will have to be developed to cater to the segment. For instance, the minimum investment stipulated of Rs. 6000 may be too high. As micropensions will involve small value frequent

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installments, a transaction fee of Rs. 20 payable each time a contribution is made will make it unattractive. Moreover, the choice of distribution channels will need to include micro finance institutions that have the ability to provide the doorstep service preferred by this segment. The use of post offices that have a presence in remote areas can also be considered.

The NPS is however a favorable development in the context of micropensions in India as it is expected to provide the policy and regulatory environment for long term retirement savings in the country.

III. Issues in Designing Micropensions

Type of Pension Scheme

In general, a pension scheme may be of defined contribution (DC) or defined benefit (DB) nature. In a DC scheme, while contributions are explicitly defined, benefits are not. This is because the risks associated with investing them, and then converting them to a regular retirement income stream are borne by the individual members. In contrast, in Defined Benefit (DB) scheme, the benefits to be provided are explicitly stated, while contributions are left undefined. In a DB scheme, it is the plan sponsor which bears the investment, mortality, and other risks.

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In the case of micropensions, typically there is no sponsor. Involvement of the Government as sponsor is desirable from the social security perspective, but may not be feasible due to severe budgetary constraints on most developing country governments.

Hence a micropension scheme is typically designed as a defined contribution scheme. The scheme essentially operates on the principle of voluntary savings accumulated over a long period. These savings are intermediated through financial and capital markets by a professional fund manager. At an agreed upon withdrawal age (usually 58 or 60 years) the accumulated balances can be withdrawn in a lump-sum, a phased withdrawal, annuity or some combination of these methods.

As is apparent from the above, a micropension plan has a distinct accumulation phase as well as a pay-out phase. During the accumulation phase of a DC plan, a member contributes towards accumulating balances. The value of such accumulation depends on the amount of contributions (for a typical formal sector DC plan, covered wage level times the contribution rate) less pre-retirement withdrawals plus returns (net of investment management expenses) obtained from the investment of funds less applicable taxes. It is usual for administrative expenses to be borne by the members collectively. These however need to be transparent and benchmarked. The accumulation phase is followed by the pay-out phase which commences usually after retirement³. During this

³ The age at which final withdrawal is permitted may or may not coincide with the retirement age.

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phase, the member receives income from the pension fund either in lump sum or in a phased manner.

Product Features

A pension product for low income groups needs to be designed to take into account their constraints and needs.

As income streams may be uncertain or volatile, the product needs to offer a degree of financial flexibility calling for low or no minimum deposit requirements so as to encourage membership. However, too low and sporadic deposits may not provide sufficient income security, so an encouragement design to encourage larger deposits could be attempted.

Experience with microsavings indicates that low income groups prefer small value frequent deposits rather than infrequent larger value deposits. As there are competing demands on their resources, it is difficult for these groups to accumulate large amounts. In order to be able to make frequent deposits, convenient door to door deposit collection is favored to save prohibitive time and travel costs.

Further, the product features should be simple to enable even those with low financial literacy to understand and monitor them. Products such as Grameen Bank's GPS had a

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fixed rate of return for a specified period, making it easier for members with low financial literacy to understand the product features.

The duration of pension products has to essentially be long term, though a roll over option after ten year terms may be less daunting for low income groups (WWB,2003).

The other alternatives are to provide easy withdrawal options or loans against deposited amounts.

Risks to be mitigated

In the pay-out phase, longevity, investment and inflation risks need to be addressed. In addition, survivors' benefits and disability insurance are also essential. Survivors' benefits in the case of male members are particularly important in India as life-time labor force participation of women is relatively low. Even when they do participate, women as a group earn less than men and therefore require more years of support. Uneven property rights and social status of women, particularly of widows, are additional reasons to provide survivors' insurance benefits. Hence more systematic consideration of these issues, informed by international experiences and analytical insights is needed.

The longevity risk concerns the fact that while each person is certain to die, the age, the cause, and the place of death are not known. Some may die within a short period after retirement; while others may live for a much longer period. The latter category of persons

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may find their financial resources exhausted, while those dying early in retirement may not face this challenge

The earlier the age at which final withdrawal is permitted, the longer the period for which the accumulated balances will be required to be used to finance old-age. In 2001, in India, average men and women at age 60 had life expectancy of 16 years and 17 years respectively. This implies that accumulated balance in provident fund at age 55 will on an average need to last for 21 years for men, and 22 years for women. For some groups, such as civil servants, the life expectancy is much higher⁴. Moreover, the dispersion around the mean life expectancy should also be taken into consideration. India's demographic trend therefore suggests that there will be considerable lengthening of the pay-out phase. Regional and group variations will however be considerable.

Investment risk refers to the risk of return from the portfolio that the pension fund invests in. In the risk-return continuum, a lower degree of risk is desirable for micropension plans due to the lower risk bearing capacity of the low income population. In order to ensure adequate rate of return on the small deposits, the transaction costs involved need to be kept low.

Inflation risks are important keeping in view the long time horizon that micropensions entail, particularly in view of the limited resources of the poor. In Africa, inflation risk is

⁴ According to LIC (1996-98) Occupational Pensioners Mortality, the life expectancy at age 60 was 22.5 years for all occupational pensioners.

one of the main reasons for old age savings being primarily in kind such as investments in land, housing, livestock etc. (Moullick et.al., 2005). Until providers develop the ability to invest the funds in inflation safe vehicles, limiting the term length as in the case of the Grameen Bank's GPS is one way to mitigate inflation risk. Rutherford (2008) suggests a role for donors in setting aside contingency funds to protect savers from inflation losses.

IV. MFIs as channels for organizing micropensions in India

As explained above micropensions essentially need to offer a reliable means for collection of small value deposits on a regular basis at locations convenient to the customer. Given the large geography of the country, micropensions need a distribution channel that reaches into the interior areas.

The growth of the microfinance sector in India suggests that MFIs could be an important channel, given that they cater to similar target segments and operate by way of regular meetings with the customer at their location or in their neighborhood.

There are a total of 54⁵ million microfinance customers in India served by two models, the Self help group (SHG) bank linkage model and the MFI model. The growth in outreach of the former in 2006-07 was 18% while that of the latter was 40%. While these numbers are impressive, some studies such as the Intellectap study entitled "Inverting the

⁵ Microfinance State of the Sector Report 2008

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Pyramid” (2007) estimate that the potential market may be as big as 245 million, in which case there is still a lot of scope for the sector to grow.

The core activity of most MFIs in India is providing microcredit. Deposit mobilization is only permitted in the case of MFIs which are registered as local area banks or cooperatives. Recently, not-for-profit MFIs have been permitted to function as business correspondents for commercial banks and offer savings services on behalf of them. Most of the national level large MFIs are registered as non bank finance companies and are not permitted to accept customer deposits. Proposed policy reforms on the horizon, are expected to allow more categories of MFIs to offer savings services to clients.

A number of MFIs have additionally started providing insurance, in partnership with mainstream insurance providers. A recent partnership between a leading MFI and a well known remittance provider saw a similar development on the remittance front. These developments indicate that there is scope to also provide micropensions to make available a more complete range of financial products to the MFI customer.

Micro-credit loans essentially are short term in nature and range between one year and three years, with a one year term being the most common. While repeat loans are often observed, the time horizon is usually not as long as that of micropension schemes. Hence there is likely to be a timing mismatch which means that the two services may not overlap entirely and to that extent there may not be cost savings.

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However as compared to any other entity, the MFI is in the best possible position to provide micropension services as their field officers visit the neighborhoods of the potential users on a regular basis.

Challenges in using MFIs for micropensions

Ross (2004) has identified five core functions of provident and pension service providers. The first involves reliable collection of contributions, taxes and other receipts, including any loan payments. The second concerns payment of benefits for each of the schemes in a timely and correct way. The third involves securing financial management and productive investment of provident and pension fund assets. The fourth core function is maintaining an effective communication network, including development of accurate data and record keeping mechanisms to support collection, payment and financial activities. The fifth is production of financial statements and reports that are tied to providing effective and reliable governance, fiduciary responsibility, transparency, and accountability. To the above list, a sixth function may be added in the context of micropensions. It is to provide necessary financial education and literacy.

MFIs are well placed to perform the first two functions because of their experience in disbursing and collecting microcredit loans but the other functions need to be addressed more carefully.

Financial management and investment

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The asset management and investment functions will need to be outsourced by MFIs as they usually do not have in house capacity to handle these functions. For long saving terms, the potential risks for providers and consumers tend to increase calling for professional fund management. Selecting an appropriate fund manager is important keeping in view the vulnerabilities of the low income groups. A thorough understanding of the fund's objectives, its performance, its expertise and its ability to service a large number of small accounts is essential.

WWB (2003) advocated that MFIs offer hybrids between microsavings and micropensions as a first step towards building capacity to offer micropensions. Alternatively, it was suggested that micropensions be developed and offered in partnership with experts such as asset management companies. As is illustrated by the example of CARD (Centre for Agriculture and Rural Development), a Philippines based MFI, with respect to insurance, developing financial products without expertise or a partnership with a formal provider can have consequences that can even threaten the existence of the institution (McCord and Buczkowski,2004) .

Other options suggested by Rutherford (2008) are endowments and annuities. Endowments attach life insurance policies to commitment savings plans and add security if the life insured is that of the bread winner. Annuities⁶ may be an option for formally

⁶ A life annuity converts a stock of wealth into a flow of income that is payable to the beneficiary (called an annuitant) until death. The annuity insures him or her against longevity risk. I.e. It insures against running out of savings to support consumption expenditure in old age. (Cannon and Tonks, 2008, p. 1). The mortality risk is the main risk faced by the life insurer, while investment risk is the main risk in provision of annuities. Increases in life expectancy therefore reduce life insurance costs, but increase the annuities cost, i.e. lower annuity benefits for a given capital sum. The risk profile of those voluntarily seeking annuities increases if there is

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employed low paid workers though developing them for informal sector workers may need considerable actuarial skills. Moreover, pricing of annuities to be paid till death (uncertain term) presents challenges. Rutherford suggests fixed term annuities for which pricing is easier to calculate, as a transition step.

Record Keeping

While MFIs are experienced in record keeping, the function is less complex in the case of microcredit as compared to micropensions. In the former case, loan amounts are the same for all group members and the collection is also by way of equated installments. Hence uniform amounts are disbursed and collected from all members in a group. Moreover, usually partial payments are not permitted. These features make record keeping in the case of microcredit loans much easier. In the case of micropensions, contributions may show considerable variance both between individuals and for an individual in different time periods. MFIs officials will need to need to upgrade their information systems to gear up to provide for varying deposit amounts. The field officers will also need training to handle the more complex record keeping responsibilities.

The fact that group loans account for a large proportion of microfinance in India, means that very often record keeping by MFIs is at the group level and detailed individual customer level data are not maintained. Micropension schemes will however require

significant adverse selection problem, i.e. those who are especially likely to live longer constitute disproportionately large proportion of the demand for annuities.

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individual record keeping and to that extent may require investment in building individual level records. This exercise may however be useful to MFIs in other ways too as a strong case can be made that if the potential of micro-finance is to be realized, individual loans need to eventually be provided.

Communication

Field staff of MFIs will need to be trained to explain the concepts of pension plans to potential users. The product is typically more complex than most other microfinance products as it involves a long time horizon and distinct accumulation and payout stages. Training on financial planning for MFI customers needs to precede marketing for pension products in order to enable them to better appreciate their utility.

Moreover, the communication with potential customers needs to be creatively thought through. For instance, in the case of a long time horizon product such as micropensions, fixed interest rates may be difficult to offer and flexible interest rates may be more appropriate. The concept of flexible interest rate may however be hard to explain to customers with low financial literacy. It is however incumbent upon institutions to effectively explain the product to customers (WWB, 2003). It is important that the potential customers be equipped with enough knowledge to explain the products to their family members.

Other Challenges

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Only established MFIs having the reputation required to market a scheme involving payouts over a long period of time can effectively market micropension schemes. While customers may be willing to avail micro-credit from less established institutions, they may not be willing to place long term savings with them. Hence to that extent the use of the MFI channel may be limited by the capacity of large MFIs to service the target market. The recent financial crisis has brought into focus the need for societal actions to sustain “deserved trust”. Deserved trust has three components, namely, competence, integrity and regulation (Asher, 2009). Regulation of the microfinance sector will therefore be an integral factor in development of micropensions.

While bundling of micropensions with other MFI services is desirable to reduce transaction costs, individual members may fear that when the provider of microcredit is also the administrator of the micropension schemes, at the time of default, the savings under the schemes may be adversely affected. MFIs need to be transparent and clarify these issues at the time of launch of the micropension scheme. A provision to avail loans against savings may be introduced.

In some MFIs where continuous borrowing is almost a condition for membership, simultaneously servicing a loan and the micropension scheme may be difficult for members and hence Rutherford (2008) suggests that MFIs advise younger MFI members to avail microcredit for investment purposes and the middle aged members to contribute to micropension plans.

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Micropension plans being long term in nature, portability of accounts will give freedom to members to move their account to other MFIs. The increasing competition in the sector is likely to provide more options to members and long term micropension plans should not prevent them from taking advantage of the situation. Portability is also essential in view of probable geographical mobility during the long time span.

Further research is needed on whether users are comfortable in using the “public” platform of group meetings for making retirement savings, which they may not want to reveal to other family members.

However, in spite of these challenges, the case for using MFIs which have passed due diligence process, for organizing micropension services is strong. These institutions have incurred the establishment costs in various locations, including remote rural areas. Many of them also have experienced personnel who can with some additional training market and administer these schemes.

Micropension plans in India

In India, insurance companies and mutual funds have been offering pension plans for individuals; however only one mutual fund, UTI AMC (Asset Management Company) began offering plans in 2006 which can be loosely termed as micropensions. The

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sponsors of UTI AMC, a fund which manages a corpus of around Rs. 460 billion⁷, are three public sector banks and a public sector insurance company, the Life Insurance Corporation of India, making it an essentially publicly owned entity.

This was followed by the launch of the Rajasthan Vishwakarma Unorganized Sector Workers (Motivational) Contributory Pension Scheme in August 2008. This scheme is being jointly implemented by the Rajasthan state government and Invest India Micropension Services Limited, a company set up by a group of leading NGOs and activists for the purpose of providing services for design and implementation of sustainable and scalable micropension and microinsurance schemes for low income groups.

The following section will examine these two schemes in more detail.

V. Micropension Schemes in India: Two Case Studies

UTI Micropension Scheme

The UTI micropension is based on small value of deposits (ranging from Rs. 50 to Rs. 200 per month); flexibility in payments (monthly or yearly contributions are not

⁷ As on January 31, 2009

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mandatory), and presence of a third party, such as a cooperative, SHG, MFI or an NGO.⁸

The non-mandatory nature of the contributions is an important departure from the traditional pension plans. The contributions must typically be made until age 55 and the pension payments begin after age 58, with nomination facility being available on death of the person.

The role of the third party is to be a locus for generating a large number of members with common characteristics; to undertake certain administrative functions; and act as a channel of communication. If instead the traditional agent model is used to obtain members, costs of customer acquisition and costs of servicing the account will be significantly higher. The value of micropension accounts being small, these costs on a proportionate basis could impact the viability of micropensions. The third party assists in reducing transactions costs involved by identifying members, collection of contributions and record-keeping. The savings from members are pooled and transferred to UTI for funds management. Records are maintained on an individual basis and each member receives a unique account number.

The third party must therefore command trust and confidence of the members as well as be competent in administration and financial matters. Moreover both the trust and the competence must be sustained over a long period. Increasing supply of such third parties is therefore critical to expanding the reach of micropensions.

⁸ If the third party uses traditional agent model to obtain members, costs will be higher, impacting the viability of micropensions.

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The first micropension scheme with UTI asset management company (AMC) as the fund manager was launched in partnership with an urban cooperative bank run by SEWA (Self Employed Women's Association) an MFI. Thereafter schemes have been launched with COMPFED, a federation formed by milk producers in Bihar; Paradip Port and Dock Mazdoor Union (a labor union), self help groups of REPCO Bank, Union Bank of India and Bank of India and an MFI, SHEPHERD (Self Help Promotion for Health and Rural Development) and Mann Deshi, a cooperative bank.

The fund management is done by UTI. A maximum of 40% of the corpus is invested in equity and the balance is invested in debt. Actual investment in equity is however around 20%. The target appears to be an annual return of 10 to 12 % after all expenses. It is too early to evaluate the extent to which the target is likely to be achieved. UTI AMC has made only minor adjustments in their usual charges levied for managing regular pension funds. The management fees range from 1.75% to 2.5% of assets depending on the assets under management. There are however, no empirical studies available as yet to estimate such costs as a percentage of contributions and of assets and their behavior over time.

Unlike in the case of regular pension plans, there is no entry load. But exit load of 1% is levied if amounts are withdrawn before the agreed upon retirement age. The exit load appears to be harsh given the fact that economic and financial uncertainties and liquidity and credit access constraints loom large for the members of micropension schemes.

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Perhaps zero exit load after five to eight year membership could be considered. Alternatively provision of loans against deposited amounts may be offered.

The structure of the pay-out phase in the UTI AMC's micropension plans appears to have received less attention. A phased or systematic withdrawal plan has been proposed after retirement until the amounts are exhausted. Till then, the amount will continue to be invested as in the accumulation phase. This pattern may be too risky given the volatility in the capital markets. Moreover, there are many different ways to structure phased withdrawals. Greater attention to this design issue is warranted, including the costs to the members of different types of options.

In savings-based micropension schemes, investment, macroeconomic and other risks are borne by the individual. Risk-sharing arrangements have therefore been often advocated. Some have argued for co-contributions by the government at the accumulation stage for participants in micropensions. Other options include risk sharing by the society (through government) at the pay-out phase. These could be in the form of special bonds or bank deposits with higher interest rates for senior citizens (with a cap on total investment) which vary according to market interest rates on long-term government bonds. This can be combined with well-targeted and reasonably funded old age assistance schemes financed from general budgetary revenue.

More research is needed in the Indian context before designing risk-sharing options. In particular, political economy considerations, where populist policies often trump

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financial and economic sustainability, should play an important role in design of such options. It would appear that co-contributions by the government at the accumulation stage may be particularly vulnerable to dysfunctional populist policies.

The issue of who should bear the costs of the services of the third parties needs to be considered. If full costs are charged to members, micropension schemes may become financially unviable. Rigorous research efforts are needed to separate accounting and financial costs on the one hand from economic costs, which involve costing all the resources, used in delivering micropension services. Once these costs are identified, then cost-sharing arrangements among different stakeholders in both accumulation and pay-out phases can be further investigated.

In addition to design changes concerning exit load suggested earlier, the fund management fees will need to be substantially lowered. In the case of the NPS, the fund management fees based on competitive bidding is 0.009%. This is far lower than the 1.75 to 2.25 percent charged by the UTI AMC for micropensions. Admittedly, the two costs are not directly comparable. Nevertheless, they suggest possibilities for reducing costs. However, these will not come about automatically. The financial industry in general and micro-finance institutions in particular will need to be innovative. Minor modifications to existing schemes, while useful as a beginning, would be insufficient if volumes are to be increased substantially.

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For the back end operations and the MIS required for the scheme, SEWA has entered into a collaboration with Invest India Micropension Services Limited (IIMPSL), a company set up by a group of leading NGOs (including SEWA) and activists for the purpose of providing services for design and implementation of sustainable and scalable micropension and microinsurance schemes for low income groups. IIMPSL effectively results in sharing of overheads by organizations seeking to implement pension schemes. This will enable MFIs to access better technologies due to economies of scale and scope than they would have individually been able to afford.

IIMPSL primarily envisages working with MFIs, cooperatives, associations and public service networks. IIMPSL's services include individual partner level process design, information technology capacity building, training and certification. It is also in the process of developing and piloting web based social security application (sCube).

The UTI AMC is an example of provision of micropension through collaboration of MFIs with professional fund managers. The use of shared overhead costs by partnership with IIMPSL improves the viability of the scheme.

In the first one year, the UTI SEWA initiative had 40,000 enrolled members out of the target of 100,000 members. The other collaborations of UTI have been announced in the last one year and are still in the early stages.

Rajasthan Vishwakarma Unorganized Sector Workers (Motivational) Contributory Pension Scheme 2007

The scheme was launched in August 2008 and is being jointly implemented by the Rajasthan state government and IIMPSL, as the consultant and turnkey implementation agency. As mentioned earlier, IIMPSL was set up by a group of leading NGOs and activists for the purpose of providing services for design and implementation of sustainable and scalable micropension and microinsurance schemes for low income groups.

The scheme is open to bonafide resident workers of the state between the ages of 18 and 60 years belonging to 20 identified occupations. It targets those who are not members of any pension or provident fund scheme. Individual retirement accounts with unique identification numbers are opened to be maintained under a central server with IIMPSL as the record keeping agency. The accounts are portable across the state.

The minimum contribution for the scheme is Rs. 100 at one time. The scheme is a co-contributory one with the Rajasthan state Government having committed to add a matching contribution to the members' savings subject to a maximum of Rs. 1000 per annum per worker.

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The government is paying an interest of 8% p.a. on the total contributions in the retirement account. It is examining the possibility of investing the funds of the scheme with a regulated fund manager regulated by the PFRDA.

Upon reaching the age of 60 years, the member will receive a pension based on the sum total of member contributions, government contributions and interest generated.

As of September 2008, an estimated 20,000 workers from six districts of Rajasthan had enrolled for it. The state is aiming for at least half a million workers to be covered by 2010. IIMPSL estimates that out of the 80 million workers capable of saving for retirement, at present only 5% are doing. They also estimate the size of untapped savings to be as high as Rs.110 billion.

The Rajasthan micropension scheme is an interesting experiment though the contribution by the government will impose a fiscal cost on the state. Moreover the funds need to be professionally managed. Considering the long time horizon, maintenance of returns at the fixed interest rate being offered, may need considerable financial expertise.

VI. Concluding Remarks

Micropensions represent a long term financial contract with potential for significant agency problems. Due to the sensitivity of the population, the contingent liability is on the Government.

There is therefore a strong case for regulation of micropensions. The tabling of the Microfinancial Sector (Development and Regulation) Bill 2007 provides for regulation of the microfinance sector. Regulation is a positive step, which will result in mainstreaming of this sector.

Similar regulation of micropensions is required. It is suggested that the PFRDA when it is formally functioning should consider forming a separate division for micropensions⁹. The division should work closely with SEBI (Securities and Exchange Board of India), IRDA (Insurance Regulatory and Development Authority) and the proposed regulator of the microfinance sector, NABARD (National Bank for Agriculture and Rural Development) so as to prevent regulatory arbitrage and bring coherence to the micropensions sector.

The regulator should also play a development role by promoting professionalism and financial literacy. Regulation should also oversee selling practices with the threat of punitive action in case of unethical selling practices such as misleading customers regarding the financial products being sold.

The NPS which is to be launched in April 2009, is a favorable development for micropensions in India as it is expected to provide a policy and regulatory environment for long term retirement savings in the country. The PFRDA has a big responsibility in ensuring that the trust deposited in it is well deserved.

⁹ The PFRDA Bill has been introduced in Parliament since 2004 but has not yet been passed

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The current micropension arrangements in India are based on relatively minor modifications of the existing pension schemes. In order to expand coverage and increase the attractiveness of micropensions, transaction costs need to be reduced.

As Prahalad (2005) has persuasively argued, in offering standard middle and high income products to those at the “bottom of the pyramid”, social entrepreneurship (along with social responsibility) which radically reduces transaction costs and results in genuine resource cost savings without compromising on quality is essential. This is the direction which micropension reforms should take. The use of shared overhead costs by micropension providers partnering with organizations such as IIMPSL is a step in this direction.

The use of automated payment technologies such as mobile phones, automated teller machines (ATMs), internet payment processors and smart cards are promising developments which could make products such as micropensions which revolve around large number of small value money transfers highly attractive.

Differentiated products need to be developed for different income segments even within low income groups with higher degree of flexibility being offered to the poorest segments.

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Research on micropensions is in its infancy. Implications of alternative designs and delivery systems for micropensions need to be rigorously researched for financial sustainability and for their impact on the level of benefits to members. Different risk-sharing arrangements among all the stakeholders also need to be explored.

With appropriate regulation and more robust risk sharing arrangements, there is potential for micropensions to play a useful role as an integral component of India's social security system.

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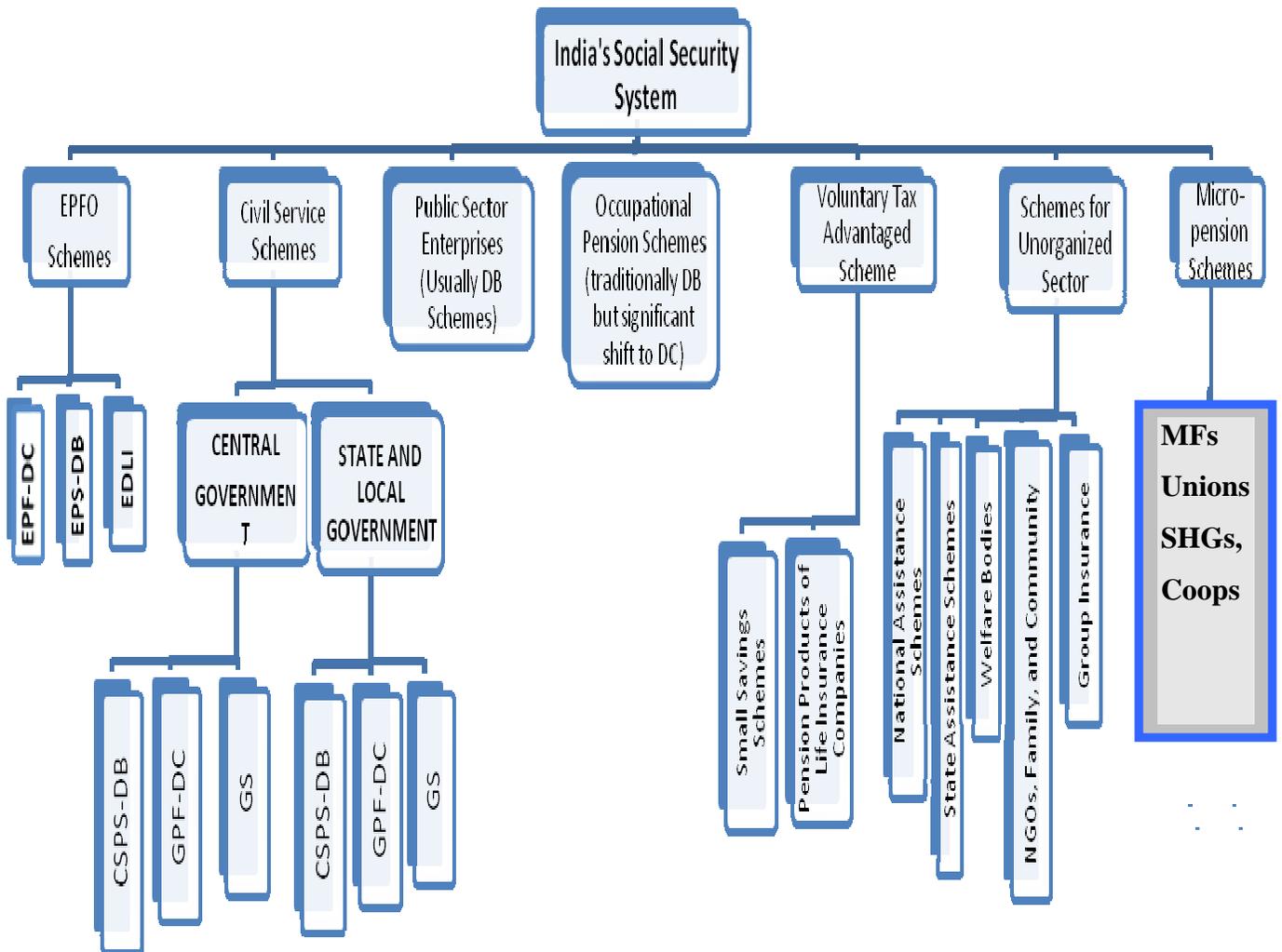
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Figure 1

India's Social Security System

From January 1, 2004, all newly recruited civil servants at the Centre (except for armed forces) are on a DC scheme. 16 states have also issued notification for a shift to a DC scheme, but their starting dates vary.



Abbreviations Used

- DB Defined Benefit
- DC Defined Contribution
- EDLI Employees' Deposit Linked Insurance Scheme
- EPF Employees' Provident Fund

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EPS	Employees' Pension Scheme
GPF	Government Provident Fund
GS	Gratuity Scheme
Coops	Cooperatives
CSPS	Civil Service Pension Scheme
MFs	Mutual Funds
NGO	Non-Government Organizations
SHG	Self Help Groups

Source: Asher (2007)

