National Pension System

For the generic concept, see National pension.

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The neutrality of this article is disputed. (December 2013)

National Pension System (NPS)

Type of project	management pension fund
Location	Mumbai, Kolkata
Country	India
Website	www.npscra.nsdl.co.in

The National Pension System (NPS) is a voluntary defined contribution pension system in India. National Pension System, like PPF and EPF is an EEE (Exempt-Exempt-Exempt) instrument in India where entire corpus escapes tax at maturity and entire pension withdrawal amount is tax-free.[1]

NPS started with the decision of the Government of India to stop defined benefit pensions for all its employees who joined after 1 January 2004. While the scheme was initially designed for government employees only, it was opened up for all citizens of India between the age of 18 and 60 in 2009.[2] In its overall structure NPS is closer to 401(k) plans of the United States. Administered and regulated by the Pension Fund Regulatory and Development Authority (PFRDA)(Based on the recommandations of Chakka Muni Balaji Ganesh Committee),in accordance with (Juturu Sahithi committee).[3][4][5][6]

On 10 December 2018, Government of India made NPS an entirely tax-free instrument in India where entire corpus escapes tax at maturity, the 40% annuity also became tax-free.[7] The contribution under Tier-II of NPS is covered under Section 80C for deduction up to Rs. 1.50 lakh for income tax benefits, provided there is a lock-in period of three years.[8][9][10][11] The changes in NPS will be notified through changes in The Income-tax Act, 1961, which is expected to happen through the Finance Bill in 2019 Union budget of India.[12] NPS is limited EEE, to the extent of 60%.[13] 40% has to be compulsorily used to purchase an annuity, which is taxable at the applicable tax slab.[14]

Contributions to NPS receive tax exemptions under Section 80C, Section 80CCC and Section 80CCD(1) of Income Tax Act. Starting from 2016, an additional tax benefit of Rs 50,000 under Section 80CCD(1b) is provided under NPS, which is over the Rs 1.5 lakh exemption of Section 80C.[15][16][17] Private Fund managers are important parts of NPS.[18][19][20] NPS is considered one of the best tax saving instruments, after 40% of the corpus was made tax-free at the time of maturity and it is ranked just below Equity-linked savings scheme(ELSS).[21]

Background

The National Pension System (NPS) is a voluntary defined contribution pension system administered and regulated by the Pension Fund Regulatory and Development Authority (PFRDA), created by an Act of the Parliament of India. The NPS started with the decision of the Government of India to stop defined benefit pensions for all its employees who joined after 1 January 2004. While the scheme was initially designed for government employees only, it was opened up for all citizens of India in 2009. NPS is an attempt by the government to create a pensioned society in India. In its overall structure NPS is closer to 401(k) plans of the United States. Today, the NPS[22] is readily available and tax efficient under Section 80CCC and Section 80CCD. Under the NPS, an individual can contribute to his retirement account. Also, his employer can contribute to the welfare and social security of the individual.

NPS is a quasi-EET instrument in India where 40% of the corpus escapes tax at maturity, while 60% of the corpus is taxable.[23][24][25] Of the 60% taxable corpus, 40% is tax-exempt as it has to be compulsorily used to purchase an annuity.[26] The annuity income will be taxed, though. The remaining 20% alone will now be taxed at slab rates on withdrawal.[27] NPS offers subscribers a choice of two record keeping agencies: NCRA (NSDL-CRA) and KCRA (Karvy-CRA).[28][29] In 2017 Union budget of India, 25% exemption of the contribution made by an employee has been announced as a form of premature partial withdrawal in NPS.[30] This amendment will take effect on 1 April, 2018 and will, accordingly, apply in relation to the assessment year 2018-19.[31][32] NPS is a market-linked annuity product.[33]

Regulatory framework

In 1999 the Government of India commissioned a national project, OASIS (an acronym for "old age social and income security"), to examine policies related to old age income security in India. Based on the recommendations of the OASIS report, the Government of India introduced a new Defined Contribution Pension System for the new entrants to Central/State Government service, except to the armed forces, replacing the existing system of the Defined Benefit Pension System.

On 23 August 2003, the Interim Pension Fund Regulatory & Development Authority (PFRDA) was established through a resolution by the Government of India to "promote old age income security by establishing, developing and regulating pension funds, to protect the interests of subscribers to schemes of pension funds and for matters connected therewith or incidental thereto." The Pension Fund Regulatory & Development Authority Act was passed on 19 September 2013 and notified on 1 February 2014, thus setting up PFRDA as the regulator for pension sector in India. However, there remains a considerable amount of confusion with other entities like the Employee Provident Fund, pension funds run by life insurers, and mutual fund companies being outside the purview of PFRDA.

The contributory pension system was notified by the Government of India on 22 December 2003, now named the National Pension System (NPS) with effect from 1 January 2004. The NPS was subsequently extended to all citizens of the country with effect from 1 May 2009, including self-employed professionals and others in the unorganized sector on a voluntary basis.

Architecture

Unlike traditional financial products where all the functions (sales, operations, service, fund management, depository) are done by one company, NPS follows an unbundled architecture where each step of the value chain has been made disjointed from the other. This unbundling not only allows the customer to mix and match his providers of service through the value chain, picking the best-suited option, but it also curbs the incidence of misselling.

NPS architecture consists of the NPS Trust, which is entrusted with safeguarding subscribers' interests, Central Recordkeeping Agencies (CRAs) which maintains the data and records, Point of Presence (POP) as collection, distribution and servicing arms, pension fund managers (PFM) for managing the investments of subscribers, a custodian to take care of the assets purchased by the fund managers, and a trustee bank to manage the banking operations. At age 60 the customer can choose to purchase pension Annuity Service Providers (ASP). NPS investors can't opt for two pension fund managers, neither can switch to another pension fund before a year. In 2017, PFRDA increased the entry age in NPS to 65 years.[34]

The number of pension fund managers (PFM) has increased to 9 in NPS:[35][36]

SBI Pension Funds

LIC Pension Fund

UTI Retirement Solutions

HDFC Pension Fund

ICICI Prudential Pension Fund

Kotak Pension Fund

Reliance capital Pension Fund

Birla Sun Life Pension Management Ltd.

SBI Pension Funds is the largest pension fund manager (PFM) in India and its assets under management(AUM) level is Rs 61,000 crore.[37] At Present, Central government employees have no say in the matter of choice of fund manager or investment allocation in NPS, as both are decided by the government. All the NPS contributions of Central government employees are being distributed evenly across three public sector fund managers :LIC Pension Fund, SBI Pension Fund and UTI Retirement Solutions.

The current CRAs are the NSDL e-Governance Infrastructure Limited (NCRA) and Karvy Computer Shares Pvt Ltd (KCRA). All the major commercial banks, brokers and Stock Holding Corporation Ltd perform the role of PoP. The subscriber can choose any one of them. There are seven fund managers and eight annuity service providers for subscribers to choose from. The subscriber can choose to invest either, wholly or in combination, in four types of investment schemes offered by the pension fund managers. These are:

Scheme E (equity) which allows up to 75% equity participation, this is invested in stocks.

Scheme C (corporate debt) which invests only in high-quality corporate bonds upto 100%.

Scheme G (government/Gilt bonds) which invests only in government bonds upto 100%.

Scheme A (Alternative Investment)which allows up to 5% (Newly added asset class only for private sector subscriber with active choice)

Alternatively, the subscriber can opt for the default scheme, whereas per the time left to retirement his portfolio is rebalanced each year for the proportion of equity, corporate bonds, and government bonds.

NPS offers two types of accounts to its subscribers:

Tier I :The primary account, which is a pension account which has restrictions on withdrawals and utilization of accumulated corpus. All the tax breaks that NPS offers are applicable only to Tier I accounts.

Tier II: In order to introduce some liquidity to the scheme, the PFRDA allows for a Tier II account where subscribers with pre-existing Tier I accounts can deposit and withdrawn monies as and when they want. NPS Tier II is an investment account, similar to a mutual fund in characteristics.[38]

The contribution to voluntary savings account (also called Tier-II account) can only be made by the subscriber and not by any third party.[39]

PFRDA has introduced new features to NPS in 2016, including more choices to lifecycle funds:[40]

Aggressive Life Cycle Fund (LC-75) which allows subscribers equity exposure of up to 75% till 35 years of age. This is more suitable to a 20s investor.[41]

Conservative lifecycle fund with a 25% starting equity exposure, may be suited to older investors.[42]

Automatically Lifecycle Fund.

The regulator add a new asset class Alternative Investment Funds (AIF) to the existing menu of equities, government securities and corporate bonds, available on NPS.

Who can join

A citizen of India, whether resident or non-resident can join NPS, subject to the following conditions:

The subscriber should be between 18 and 60 years old as of the date of submission of his/her application to the Point of Presence (POP) / Point of Presence–Service Provider-Authorized branches of POP for NPS (POP-SP).

The subscribers should comply with the Know Your Customer (KYC) norms as detailed in the subscriber registration form.

Should not be Un-discharged insolvent and individuals of unsound mind.

Subscriber base

As of December 2016, the number of subscribers had grown substantially to 1.41 crore. NPS AUM (assets under management) grew to Rs 1,61,016 crore as of December 2016. 88% of total NPS AUM is accounted for Government sector, both Central and State employees, who also account for 35 per cent of the number of subscribers.[43] As of March 2016, The total AUM of the NPS Tier II segment is Rs 197 crore. NPS Tier II has 34,620 subscribers with an average balance of Rs 54,000.[44]

Opening an account

Online process via eNPS

e-NPS started in 2015. an NPS account can be opened online using either of the two options available to complete the KYC process:[45][46]

One, Aadhaar-based KYC, wherein you will be authenticated through an OTP that will be sent to the mobile phone number that is registered with Aadhaar. Once one authenticates oneself, the KYC information will be taken from the Aadhaar database. If you had selected Aadhaar-based registration, you have to upload a scanned signature. You can make your investment through Net banking from any bank's account.if you choose Aadhaar-based KYC, you don't have to sign and send the physical form. You can simply e-sign. There is no need to print the NPS form that you had filled online and submit the printout within 90 days to the central record keeping agency.

Second way to proceed is to give the permanent account number (PAN) and bank account details to complete the KYC authentication step.

Offline process

For offline opening, one has to visit any of the Points of Presence (POPs) appointed by the PFRDA.[47]

Withdrawal

Premature withdrawal in NPS before age of 60 years required parking 80% of the sum in an annuity.[48] One can withdraw 20 percent of the corpus before 60 years but he/she must buy annuity with 80 percent of the corpus.[49] In 2016, the NPS allowed withdrawal of up to 25% of contributions for specified reasons, if the scheme is at least 3 years old with certain conditions. One can withdraw the complete amount if the pension collected is less than INR 2,00,000.[citation needed]