All you wanted to know about the New Pension System

There has been a lot of talk about the New Pension System (NPS) since the past one year. NPS is a social security benefit offered by the government to target the majority of population that does not have/does not receive pension benefits from its employer.

It is a defined contribution scheme (unlike EPF, PPF where returns are guaranteed by the government) regulated by the Pension Fund Regulatory and Development Authority (PFRDA).

The investment in NPS is to be maintained until maturity/retirement. Upon retirement, a part of your corpus will be allowed to be withdrawn as lump sum, and the balance will be mandatorily paid out as pension annuity.

Let's look at the salient features **of NPS:**

Who is covered?

Any individual between the age of 18 years and 55 years is covered. He could be a resident or a non-resident.

What is the mode of operation?

Step -1: An individual needs to open an NPS account with one of the NPS' distribution agents (banks, post offices etc.). The individual will be offered 2 accounts – TIER I and TIER II; TIER I is mandatory for all individuals opening an NPS account. On opening an NPS account, the individual is issued a Permanent Retirement Account Number (PRAN). This number remains with the individual for his life, even if he changes jobs/location. He would also be able to transact online. Currently, only TIER I is operational. TIER II is yet to be launched.

Step-2: Once the account is opened, the individual can choose the mode of operation of his/her account – which is: manual or auto.

Under manual operation, he can choose the investment options as per his risk profile (alike a ULIP). There are 3 investment options – (a) equity, (b) debt – government securities and (c) debt – non-government securities.

Under auto operation, the funds will be invested up to 50% in equity by default and the rest in debt. As maturity approaches, the funds are gradually switched to debt option in order to protect the fund from market fluctuations. Investment in equity however, is only through index mutual funds and the maximum allocation to equity is 50 % of the investible amount. The individual can also choose from

the list of designated pension fund managers (currently six) to manage his pension fund.

NPS provides flexibility to subscribers where they can switch their pension funds among the three options and change fund manager if not satisfied with their performance.

Step-3: The contributions made on regular basis would grow and accumulate over the years, depending on the efficiency of the fund manager.

Step-4: On maturity, the individual has a choice to withdraw up to 60 % of the pension fund; Balance 40% is paid out by way of monthly pension.

What are the minimum and maximum investments in NPS?

The minimum investment is Rs 6000 per year. There is no upper limit on the maximum contribution per year. However, each transaction done through NPS attracts cost (Rs 10 currently).

What kind of returns would the NPS generate?

The returns would be higher than traditional debt investments (such as post-office schemes, bank deposits etc.) due to equity element in the investment. However, the risk will be much lesser than equity-oriented mutual funds and returns generated by investing in direct equity. This is because investment in equities is allowed through index funds and exposure to equity has been capped at 50%.

Is pre-mature withdrawal allowed? If so, what is the withdrawal limit?

The withdrawal limit will depend upon the age of the subscriber. If the subscriber withdraws/ exits the scheme before the age of 60 years (ie premature withdrawal) –Withdrawal limit is 1/5th of the accumulated savings in the account. The rest must be invested in annuities offered by insurance companies.

If the subscriber withdraws/exits the scheme when his age is between 60 and 70 years (ie on or after maturity) – he will be able to withdraw/commute up to 3/5th(or up to 60 %) of the accumulated savings in the account. The balance 2/5th (or 40%) must be invested in annuities offered by insurance companies.

In case the subscriber dies, the nominee has the option to receive the entire pension proceeds in lump sum.

Who are the fund managers?

Currently, there are six pension fund managers to choose from—ICICI Prudential

Pension Fund Management, IDFC Pension Fund Management, Kotak Mahindra Pension Fund, Reliance Capital Pension Fund, SBI Pension Fund and UTI Retirement Solutions. IDFC has dropped out last year.

What are the costs involved?

Transacting in NPS attracts both fixed and variable cost, which is deducted from the fund value.

Fixed cost:

One-time account opening cost and issuance of PRAN – Rs 50

Initial subscriber registration and contribution upload –Rs 40; Future fixed upfront charges – Rs 20.

Annual maintenance charges – Rs 350

Each transaction of NPS – Rs 10

The fixed cost adds up to Rs 470 per year.*

Variable cost:

Annual custodian charge - 0.0075-0.05 per cent of the fund value

Annual fund management charge - 0.0009 per cent of the fund value

Advantages of NPS:

Cost - NPS is the cheapest among current retirement products and defined contribution schemes; It is also easy to transact in NPS.

Flexibility – The subscriber is given a PRAN, which will remain with him for forever. The account is portable irrespective of change in job/location.

Returns - The returns would be higher than traditional debt investments (such as post-office schemes, bank deposits etc) due to equity element in the investment.

Disadvantages of NPS:

Taxability - The contributions get tax benefit under Section 80C. However, at the time of withdrawal, the lump sum would be taxable as per the individual's tax slab. It is a case of EET (exempt on contributions made, exempt on accumulation, taxed on maturity) unlike EPF, PPF which are EEE (exempt, exempt, exempt).

Comparison to mutual funds - Since the NPS is meant for retirement and financial security, it does not permit flexible withdrawals as are possible in the case of mutual funds.

Returns - If an individual is voluntarily investing in NPS, then he/ might as well invest in the stocks or mutual funds (MF). It is the tax benefits that would make NPS an edge above other pension products.

Conclusion:

Until May 2009, the plan was available for central government employees only. But now it has been thrown open to all individuals. NPS is still in nascent stages. It is definitely a cost efficient way of investing for retirement. However, tax on NPS is not entirely exempt currently.

Therefore, it is smarter to use up the total tax exempt investments such as PPF and then invest the balance in NPS. Once the tax benefits come through, the volumes will start increasing – which will eventually drag the costs down and make NPS one of the hot pension products.

(Business Standard)