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**Chief Editor
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www.ijmms.in

Email : ijmms14@gmail.com

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Old Age Pension Security in India

Prof. D.Chennappa
Department of Commerce
Osmania University, Hyderabad

Abstract:

The increasing life expectancy coupled with the gradual disappearance of the extended family system, makes it imperative for India to design a robust pension system to avoid impoverishment in old-age and accompanying social distress. The current scenario in India is marked by low and insufficient pension coverage. Timely and smart policy interventions, when a majority of the Indian population is still young, can help avert an impending pension crisis.

In this paper an attempt is made to address the old age pension security by using Expensive method and PMT method through MS Excel. It concludes that early age savings will met the retirement needs effectively and half of the amount is enough to save to get full benefit if he/she starts saving in pension funds at the age 35 years on words.

I.Introduction: A well-designed pension system is one which is economically and financially sustainable, while providing for a meaningful retirement income to the beneficiaries. It also accumulates long-term savings that aid investments in infrastructure. Since pension plans are very long-term plans, small changes in contributions and investment returns can make a big difference in the terminal corpus, owing to the power of compounding.

II.Employer Related Pension Plans in India: The Indian pension regime for the employed population presently has mandatory, quasi-mandatory and voluntary plans. Over the past decade, significant changes have occurred on the pension and scape in India. The various employers-depend entension plans are as follow:

2.1 Employees' Provident Fund regime: The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF Act) is the predominant social security legislation in India aimed at, inter alia, securing retirement benefits for employees. Currently, three schemes operate under the EPF Act: Employees' Provident Fund Scheme (EPFS), Employees' Pension Scheme (EPS) and Employees' Deposit Linked Insurance Scheme (EDLIS).

Application of the EPFA cttoorganizations

Broadly speaking, the EPF Act applies to the following entities:

- Every establishment which is a factory engaged in any industry specified by the central government and in which 20 or more persons are employed;
- Any other establishment employing 20 or more persons whom the central government may, by notification, specify in this behalf.

Voluntary coverage: Any establishment employing less than 20 persons can be covered voluntarily.

However, not all employees in an establishment covered under the EPF Act, are required to be rolled for contributions. Some of the employees can be excluded from participation under the EPF Act, as explained below.

Excluded Employees: An employee whose salary is greater than INR15,000 per month and who is not currently a member of the EPF scheme may be excluded from the provision so the EPF Act. This clause of salary-based exclusion does not apply to International Workers and employees working in news paper establishments.

2.3 National Pension System: The National Pension System (NPS) is an initiative by the Government of India to enable individuals to make investment decisions regarding their future and provide for their retirement through systematic savings.

NPS became operational on 1 January 2004 and was made applicable to all new employees of the central government, except the armed forces. The Pension Fund Regulatory and Development Authority (PFRDA), with effect from 1st May 2009, made NPS available to all citizens of India, on a voluntary basis.

NPS is a defined contribution scheme where in the final corpus depends upon the contribution made by subscribers and the investment returns.

In December 2011, the PFRDA introduced a corporate sector model to provide NPS to employees of corporate entities of the private and public sector enterprises. This will help the employed population in the corporate sector to avail the NPS facility through their employers.

2.3 Super annuation Funds: Super annuation Fund (SAF) is an employer-sponsored voluntary pension plan to facilitate pensions for employees when they retire/leave the organisation. SAF can be either defined contribution or a defined benefit scheme, depending upon the option selected by the employer.

An employer may create SAF through a Trust, by executing a Trust Deed and have the same approved by the income tax authorities. The Super annuation trust funds could be managed internally or through an insurance service provider which is approved by the Insurance Regulatory and Development Authority. During our research, we discovered that the number of SAFs in India is not consolidated; accordingly, the number of participants and the total corpus was unavailable. Since there is no independent regulator of SAFs in India and due to insufficient data, it becomes difficult to establish the coverage and effectiveness of this pension instrument.

I. Comparative Analysis of EPF, NPS and SAF

Features	Employees' Provident Fund (EPF)	National Pension System (NPS)	Superannuation Fund (SAF)
Membership	Employees with monthly salary of up to INR 15,000 are required members.	Any person who is a citizen of India, aged 18-60 years can become a member of NPS	Employees
Contribution	12% of salary by the	Contribution rates are	Contribution rates are

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rates	employer and employee	flexible	flexible
Benefits	Lump sum withdrawal at resignation, retirement or death Partial withdrawal for specific purpose such as house construction, higher education, marriage etc. Monthly pension at retirement or permanent disability Survivors' pension and assurance benefit on death of employee.	Partial lump sum Phased withdrawals Annuity	Partial lump sum Phased withdrawals Annuity
Investment	The accumulated are invested by the board of Trustees of EPF, as per norms laid down by Ministry of Labour and Employment, Government of India.	Subscribers may choose their own investments from three asset classes. i.e. corporate bonds, government securities and equity. The investment in equity is capped at 50 per cent.	The trustees of SAF invest the Fund as per the norms laid down by Ministry of Finance, Government of India
Tax benefit	Employee contribution is eligible for deduction from employees' taxable income up to INR 1,50,000	1) Employee contribution is eligible for deduction from employees' taxable income up to INR 1,50,000 2) An additional deduction of INR 50,000 3) Employer contribution up to 10 per cent of defined salary not included in taxable income.	Employee contribution is eligible for deduction from employees' taxable income up to INR 1,50,000 No additional deductions Employer contribution up to INR 1,00,000 is not included in Taxable income.
Tax implications on maturity/ withdrawal	Withdrawals are tax exempt	Lump sum withdrawal and annuity proceeds may be taxable.	Lump sum withdrawal amount is Non- Taxable and Annuity is taxable as salary.

II. **How to Plan a Retirement:** From 2004 on words, employees' contribution fund has been enforced by the Government of India. After retirement, employee has to plan for their own corpus fund to meet their regular expenditure. The details are as follow:

1) **Corpus identification:** The first and foremost activity when it comes to retirement planning is to identify the corpus required for retirement. There are several methods which can be used for identifying the corpus. One of such method is expense method.

Let us assume that Mr.A incurs monthly expenditure of Rs 50,000/-. He is 35 years old and his time for retirement is 25 years (if his superannuation is 60 years). Annual expenditure of Mr A is Rs 6,00,000/-. When it comes to time value of money, inflation is an important factor that needs to be considered as value of goods does not remain static. There is a need to derive at inflation adjusted expenditure. It can be calculated using the formulae [Current expense * (1+ inflation rate %)^ (time horizon to retirement)]. Let us assume an inflation of 6%. In this example, annual inflated expenses of Mr A would be Rs 25,75,122. Which means that Mr A post retirement cash flow should be at least Rs 25,75,122 per annum. Now comes the question of how many years would Mr A would live post retirement? Let us assume that he lives for 25 years post retirement, the retirement corpus should be Rs 25.27 lakhs in multiple of 25 years, which is Rs 6, 40,00,000. Therefore, it is necessary that to calculate the monthly saving which is to meet the Goal of post retirement corpus.

2) **Monthly Savings to meet the Goal:** Let us assume that a person is going to start afresh for his retirement goal and he would like to invest 60% equity and 40% in debt related instruments. For a moment let us take equity portfolio return as 17% and debt as 9%. The portfolio return would be (60% X17% + 40% X 9%) 13.8%. Now the required corpus is Rs 6.4 crores; number of years left for retirement is 25 years; and assumed rate of interest for the portfolio is 13.8%. Accordingly Mr A has to invest Rs 24,626 per month for the next 25 years to achieve his retirement corpus of 6.4 crore.

Table 1: Age wise monthly saving under National Pension Scheme

Per month Expenditure	per annum Expenditure	Age	6% inflation, Expense method	Retirement Corpus Fund	Monthly saving is required to met The monthly expenditure after superannuation
100000	1200000	35	5150244.864	128756121.6	(49,544.26)
90000	1080000	35	4635220.377	115880509.4	(44,589.83)
80000	960000	35	4120195.891	103004897.3	(39,635.41)
70000	840000	35	3605171.405	90129285.11	(34,680.98)
60000	720000	35	3090146.918	77253672.96	(29,726.55)
50000	600000	35	2575122.432	64378060.80	(24,626.65)
40000	480000	35	2060097.945	51502448.64	(19,817.70)
30000	360000	35	1545073.459	38626836.48	(14,863.28)
20000	240000	35	1030048.973	25751224.32	(9,908.85)
10000	120000	35	515024.4864	12875612.16	(4,954.43)
Per month	per annum	Age	6% inflation,	Retirement	Monthly saving

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Expenditure	Expenditure		Expense method	Corpus Fund	is required to met The monthly expenditure after superannuation
100000	1200000	40	3848562.57	76971251.33	(60,824.03)
90000	1080000	40	3463706.31	69274126.20	(54,741.63)
80000	960000	40	3078850.05	61577001.07	(48,659.23)
70000	840000	40	2693993.80	53879875.93	(42,576.82)
60000	720000	40	2309137.54	46182750.80	(36,494.42)
50000	600000	40	1924281.28	38485625.67	(30,412.02)
40000	480000	40	1539425.03	30788500.53	(24,329.61)
30000	360000	40	1154568.77	23091375.40	(18,247.21)
20000	240000	40	769712.51	15394250.27	(12,164.81)
10000	120000	40	384856.26	7697125.13	(6,082.40)
Per month Expenditure	per annum Expenditure	Age	6% inflation, Expense method	Retirement Corpus Fund	Monthly saving is required to get The monthly expenditure after superannuation
100000	1200000	45	2875869.83	43138047.48	(72,614.84)
90000	1080000	45	3463706.31	51955594.65	(87,457.53)
80000	960000	45	3078850.05	46182750.8	(77,740.03)
70000	840000	45	2693993.80	40409906.95	(68,022.52)
60000	720000	45	2309137.54	34637063.1	(58,305.02)
50000	600000	45	1924281.28	28864219.25	(48,587.52)
40000	480000	45	1539425.03	23091375.4	(38,870.01)
30000	360000	45	1154568.77	17318531.55	(29,152.51)
20000	240000	45	769712.51	11545687.7	(19,435.01)
10000	120000	45	384856.26	5772843.85	(9,717.50)

Source: calculations based on assumption of 6% inflation and 13.8 % ROI.

Per month Expenditure	per annum Expenditure	Age	6% inflation, Expense method	Retirement Corpus Fund	Monthly saving is required to met The monthly expenditure after superannuation
100000	1200000	45	2875869.83	43138047.48	(72,614.84)

100000	1200000	40	3848562.57	76971251.33	(60,824.03)
100000	1200000	35	5150244.864	128756121.6	(49,544.26)
50000	600000	45	1924281.28	28864219.25	(48,587.52)
50000	600000	40	1924281.28	38485625.67	(30,412.02)
50000	600000	35	2575122.432	64378060.80	(24,626.65)
10000	120000	45	384856.26	5772843.85	(9,717.50)
10000	120000	40	384856.26	7697125.13	(6,082.40)
10000	120000	35	515024.864	12875612.16	(4,954.43)

Source: Calculations based on assumption of 6% inflation and 13.8 % ROI.

From the above table it can be noticed that Rs 72,614 is to be saved per month from the age of 45 years to 60 years to get Rs 1,00,000 after retirement. In case he starts his savings at early age of 35 years, he has to save only Rs 49,544 to get the same amount of Rs 1,00,000/-. It is also found that if a person saves in half of his funds in NPS he will get computable benefit after retirement. It can be concluded that to get the sufficient corpus, early age savings must be started.

3) How to select the correct Investment? Now we have computed the retirement corpus and also the monthly installment that one has to make to achieve the goal. The next important question to be answered is where to invest this money. Before going ahead and seeing the various investment avenues, let us discuss about some important concepts.

3.1) Debt oriented Instruments: these instruments are predominantly safe and provides a decent return which can be more or less that the inflation. Example a) Fixed deposits, b) Senior citizen savings Plan at Post Offices, c) Post office monthly income scheme (MIS)

3.2) Equity Oriented Instruments: This is one of the most suitable investment avenue for generating corpus for retirement benefit. This should be there in every one portfolio and it should start at least 25 to 30 years before retirement. Equity diversified mutual funds are a better option and provides diversification to the portfolio. One can invest in Systematic Investment Plan (SIP) than buying lump sum at one time.

3.3) Insurance oriented instrument: insurance related instruments are essential and must be a part of one's financial planning, whether it is pre or post retirement. More number of options is available in Insurance. For Example: a) Annuity products, Regular Income plans, periodic income plan and accident plan.

3.4) Provident Fund: Provident fund becomes one of the most important retirement fund avenue as it is mandatory as per Government of India Acts. This investment will earn 8.8 % interest rate and they can avail loan against the fund.

V.Suggestion: It is important for all the key stakeholders such as the government, regulators, employees and employers must realize the importance of the NPS and to engage in a focused and constructive decision making to invest in NPS and to explore new ways to broaden and deepen pension coverage in India.

VI.Conclusion: In the last decade witnessed a significant increase in life expectancy due to advancement in medical practice and improvement in living style, which warrants the need for prolonged and sufficient post- retirement income is required. Therefore people should start the savings in NPS at early age.