NPS: benefits to get better with time

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The fee structure of the New Pension System, opened for all citizens since May 1, 2009, has attracted a lot of criticism, much of which focuses on levying administrative charges even on the minimum annual contribution of Rs 6,000. However, a patient analysis of cost structure, the nature of services of various entities and long-term benefits of retirement savings through NPS would dispel the initial impression about the charges.

NPS is a defined contribution (DC) pension system which involve several specialised entities for collecting contribution, managing funds and rendering various services to the members. The entities involved in NPS management are pension fund managers (PFM), central record keeping agency (CRA), point of presence (POP), trustee bank, custodian and annuity services providers (ASP).

These entities act in a cohesive and orderly manner under the Pension Fund Regulatory and Development Authority (PFRDA) guidelines and NPS trust supervision to ensure safety security and growth of assets to provide maximum risk adjusted return and timely service to the subscribers. The regulator needs to ensure that the cost is not a burden on the system, impacting long-term earnings of the fund. At the same time, fee structure should also provide sufficient incentives for efficient performance of the various entities involved in managing pension funds to conduct business in a professional manner, observing investment ethics.

International practice of fee structure and cost regulation in DC private pension system vary widely in different countries. While some countries put the limit on various fees, some leave them to market forces. There is also variation in the composition of fee structure globally. In most Latin American countries, fees are charged on contribution basis and some such as Peru and Columbia do not charge fund management fees separately but include it in contribution fees. Countries such as Australia and Chile charge both. Costs of managing private pension also depends on the nature of collection of contribution and record maintenance.

In Colombia, Uruguay and Poland centralised agencies collect contribution and distribute funds among the pension fund managers while Chile, Peru and Hungary have decentralised collection system and contributions are collected by the pension fund managers. In Chile, Mexico and Peru, there is no limit on fees, but there is not much variation in actual fee structure even without any cap. Average administrative charges, including funds management fees, vary from 1% to 1.8%. Generally, the asset management fees vary from 0.5% to 1.5% in eastern European countries.

Under the NPS, there are separate charges. The CRA charges Rs 50 for opening an account, Rs 350 for annual maintenance and Rs 10 per transaction. Likewise, the POPs charge Rs 40 for initial subscription registration and Rs 20 for subsequent registration and the PFMS charge investment management fees at the rate of 0.0009%. The charges for custodian and trustee bank are insignificant. Account opening and PRA maintenance charges of the CRA are not static; annual maintenance charges and per transaction fee will decline to Rs 250 and Rs 4, respectively, when the number of accounts with CRA reaches 30 lakh.

Initial charges for the minimum contribution in the initial years seem high in NPS. But it is a national scheme and open to all section of investors, therefore, the total cost will decline with an increase in contribution amount. The NPS costs are comparable with mutual fund. Some analysis shows that overall cost, including fund management, distribution, custodian, registrar and so on in case of mutual fund comes to 2.25%. However in NPS, one time investment of Rs 20,000 would cost approximately 2.21%. The most important component of investment management is the fund management fee — it is 0.0009% (based on assets under management) compared to 1.25% for the mutual fund.

Fund management fee for NPS is probably the lowest in the world. Further, there is no guaranteed return in DC. Even so, fund managers need to set an implicit performance and liability benchmark for themselves to ensure better return and to manage liability driven investment management (LIDM). NPS is, thus, a performance driven system and cost should not be considered in isolation of performance.

NPS is in its nascent stage, operationalised in phased manner since April 2008. The system is evolving and will be rationalised as time passes. Even the most successful experiment introduced in Chile in 1981 continues to undergo refinement. In that context, two-year-old NPS may be considered as an extremely successful initiative.

(The author is CEO, LIC Pension Fund. Views are personal)