How to evaluate a Pension Plan

There are many options available to an individual intending to plan for his retirement. Be it PPF, ULIP, NSC’s etc. Most retirement options fall into two categories,—those which promise a fixed assured return and those, like pension plans, which offer non-assured returns. There are very few retirement planning options available in mutual funds. At present, two funds, UTI Retirement Benefit Plan and Kothari Pioneer Pension plan fill the retirement mutual fund void. Both these schemes come equipped with Section 88 benefits and are therefore, on this count, at par with other retirement planning options like PPF, PF etc. Both the UTI Retirement Benefit Plan (RBP) and Kothari Pioneer Pension Plan (KPPP) allow the investor to plan for retirement, making it possible for him to receive regular income after retirement. Before an investor goes in for a retirement plan he needs to evaluate its various basic parameters:

**Returns** – In this case the comparison of returns vis a vis the fixed return instruments like PPF etc. is easy. The returns generated in the case of PPF is again, like Infrastructure Bonds, a fixed rate of 9.5 per cent unlike the returns of pension plans which can vary over a period of time. Also when it comes to comparing the returns between the two mutual fund options the investor must keep in mind, the track record of the scheme as well as his timing of entry. Both these factors will impact his return. However, in the case of infrastructure bonds, returns are fixed, irrespective of the time of entry. For instance Empirically, KPPP has turned in a better performance than Infrastructure Bonds so far. The fund has returned an annualised 15.20 per cent since inception as compared to a return of 9.5 per cent in the case of Infrastructure Bonds.

**Lock in period** – In case of fixed return instruments like PPF etc, the lock-in period is very long, with intermediate withdrawals after a certain number of years. In case of infrastructure bonds as well as pension funds the there is a 3 year lock-in period but in case of KPPP the withdrawal at the end of 3 years comes at a nominal penal charge.

**Liquidity** - In PPF, the liquidity is pretty low. A loan can be taken at the end of 3 years but even that is only to the extent of 25 per cent of the balance at the end of the preceding financial year. A withdrawal is permissible every year from the 7th financial year of the date of opening of the account. So, the loan and the withdrawal can be taken after a specified period of time and that too with certain riders. In the case of KPPP, the entire amount is withdrawable after the expiry of three years subject to a penal charge, otherwise the investor can exit only after reaching 58 years of age.

**Rebate Eligibility** –The tax benefits under both the PPF and the pension plans is the same in terms of the section 88 benefit which makes the investor eligible for tax benefits of 20 per cent of the amount invested in the scheme. The infrastructure bonds however offer an additional advantage in terms of enhanced amount of Rs 80,000 (link) of tax benefit under section 88.

**Taxability of Interest/Dividend** – Returns from PPF are tax free, Interest received on infrastructure bonds qualifies for tax exemption under Section 80L. This is not the case with
dividend received from pension mutual funds like KPPP. Dividend received from KPPP is subject to dividend distribution tax of 10 per cent.

**Minimum Investment** - A minimum amount of Rs 100 has to be invested every year to keep the account alive in PPF unlike the facility of investing in instalments of Rs 500 in case of KPPP. Also the minimum amount that can be invested in the pension plans is Rs 10,000. In the case of bonds the investor has to bring in a minimum amount of Rs 5000.

**Maximum Investment** - The maximum amount that can be invested under PPF in a particular financial year is Rs 60,000 whereas there is no such restriction on the maximum amount that can be invested in the pension plans. No tax benefit is however given for investments made above Rs 60,000 in the case of KPPP.

**Investment Instalments** - In the case of KPPP the minimum cumulative sum of Rs 10,000 can be invested in instalments of Rs 500. In the case of bonds the investor has to bring in the entire minimum amount of Rs 5000 in lumpsum.

**Investment Mix** - A comparison on this attribute is important when choosing between any pension plan offered by a mutual fund. Normally balanced schemes are offered. However, over a period of time the portfolio may vary. For instance ULIP has essentially become a growth scheme whereas KPPP is still focussed on debt though the equity component in the scheme has gone up over a period of time.

**Additional Benefits** - ULIP gives an insurance cover and an accident cover along with section 88 benefit, whereas, the other instruments do not offer this.
In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmriti), Yagnavalkya (Dharmasutra) and Kautilya (Arthasastra). The writings talk in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. This was probably a pre-cursor to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers’ contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular.

1818 saw the advent of life insurance business in India with the establishment of the Oriental Life Insurance Company in Calcutta. This Company however failed in 1834. In 1829, the Madras Equitable had begun transacting life insurance business in the Madras Presidency. 1870 saw the enactment of the
British Insurance Act and in the last three decades of the nineteenth century, the Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) were started in the Bombay Residency. This era, however, was dominated by foreign insurance offices which did good business in India, namely Albert Life Assurance, Royal Insurance, Liverpool and London Globe Insurance and the Indian offices were up for hard competition from the foreign companies.

In 1914, the Government of India started publishing returns of Insurance Companies in India. The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life business. In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies. In 1938, with a view to protecting the interest of the Insurance public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for effective control over the activities of insurers.

The Insurance Amendment Act of 1950 abolished Principal Agencies. However, there were a large number of insurance companies and the level of competition was high. There were also allegations of unfair trade practices. The Government of India, therefore, decided to nationalize insurance business.

An Ordinance was issued on 19th January, 1956 nationalising the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector.

The history of general insurance dates back to the Industrial Revolution in the west and the consequent growth of sea-faring trade and commerce in the 17th century. It came to India as a legacy of British occupation. General Insurance in India has its roots in the establishment of Triton Insurance Company Ltd., in the year 1850 in Calcutta by the British. In 1907, the Indian Mercantile Insurance Ltd, was set up. This was the first company to transact all classes of general insurance business.

1957 saw the formation of the General Insurance Council, a wing of the Insurance Association of India. The General Insurance Council framed a code of conduct for ensuring fair conduct and sound business practices.

In 1968, the Insurance Act was amended to regulate investments and set minimum solvency margins. The Tariff Advisory Committee was also set up then.
In 1972 with the passing of the General Insurance Business (Nationalisation) Act, general insurance business was nationalized with effect from 1st January, 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commence business on January 1st 1973.

This millennium has seen insurance come a full circle in a journey extending to nearly 200 years. The process of re-opening of the sector had begun in the early 1990s and the last decade and more has seen it been opened up substantially. In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners.

Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market.

The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26%. The Authority has the power to frame regulations under Section 114A of the Insurance Act, 1938 and has from 2000 onwards framed various regulations ranging from registration of companies for carrying on insurance business to protection of policyholders’ interests.

In December, 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted into a national re-insurer. Parliament passed a bill de-linking the four subsidiaries from GIC in July, 2002.
Today there are 28 general insurance companies including the ECGC and Agriculture Insurance Corporation of India and 24 life insurance companies operating in the country.

The insurance sector is a colossal one and is growing at a speedy rate of 15-20%. Together with banking services, insurance services add about 7% to the country’s GDP. A well-developed and evolved insurance sector is a boon for economic development as it provides long-term funds for infrastructure development at the same time strengthening the risk taking ability of the country.