



# Lessons learnt from the German Riester pension scheme and their possible application in India

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*The fairly young Indian National Pension System (NPS) aims at creating an efficient incentive and regulation structure to convince unorganised sector workers to start saving for their old age with NPS. Some lessons can be drawn from the experience of the German Riester pension scheme and applied to NPS. Reliable quality and a consumer protection system earn the trust of (future) savers. Other important factors are information centres/seminars with interesting and understandable information material. The incentive structure can be used as a tool to attract the target group and should also include incentives – in addition to short-time subsidies when signing up – and a flexible product range to maintain the scheme's attractiveness even after some years.*

## Introduction

In Germany, the idea of people saving for their old age goes back to former Reichs-Chancellor Otto von Bismarck, who developed the first formal old age pension system in the world in 1889. The German public pay-as-you-go (PAYG) system has been very successful in providing a high and stable level of retirement income at reasonable contribution rates during a contributor's working life, and it has been a model for many social security systems around the world. However, due to demographic change, the financial sustainability of the German pension system was at risk. Its last major modification included strengthening and promoting a voluntary private pension pillar supervised and subsidized by the state. This pillar includes the Riester pension.<sup>1</sup>

India is facing similar demographic problems, but also has to find solutions for a large informal sector (over 90% of the working population), most of whom are not covered by the pension system. After various reforms, in 2009 the Government of India undertook one of the most profound changes in their pension system and decided to include informal sector workers in the National Pension System (NPS). NPS is a non-mandatory defined contribution pension scheme which also provides incentives through government subsidies.<sup>2</sup>

Based on these quite similar structures – non-mandatory and state-subsidized – this paper aims at drawing lessons learnt from the Riester pension and its on-going reform

process and applying them to NPS. Firstly, a short summary of the historical background of the German pension system will be presented, followed by an overview of its current status. The Riester pension system will be highlighted. Part of Riester's success can be traced back to the right set of incentives and regulations; therefore, these will be given special emphasis and contrasted with a short overview of the Indian system. Lastly, this paper will apply lessons learnt from the Riester pension's decade of experience to the new Indian NPS. It aspires to provide relevant insights about the success of the Riester pension which will enrich ongoing discussions and reform processes of pension systems in developing and emerging economies such as India's.

## Background & Overview of the German Pension System

The generosity of the German PAYG system is considered a great social achievement, but the “intergenerational contract”<sup>3</sup> is threatened, primarily by Germany's aging population. The extreme demographic shift has been caused by a quicker increase in life expectancy than elsewhere and sharpened by a relatively low fertility rate of 1.4 children per woman.<sup>4</sup> According to Federal Statistical Office projections, the proportion of elderly persons (aged 65 and above) will

<sup>1</sup> Börsch-Supan, Wilke 2006, p. 573

<sup>2</sup> PFRDA 2010, p. 2

<sup>3</sup> The young people working for the old until they themselves are old and the new generation works for them.

<sup>4</sup> Statistisches Bundesamt 2009, p. 2

exceed 29.0% of the population in 2030.<sup>5</sup> The steep increase in the ratio of elderly to working-age persons has immediate consequences for a PAYG social insurance system because fewer workers will have to pay for the benefits of more recipients.

Despite reforms and attempts to save the pure form of the PAYG system for future generations, in 2001 Walter Riester's<sup>6</sup> reform introduced a small but growing privately funded pillar and thus a multi-pillar pension system. This was supported by the report of the Commission for the Sustainability of Financing the Social Insurance System, also known as "Rürup Commission"<sup>7</sup>, which recommended parametric changes to the PAYG system that were put into law in 2004. The new system will be fully phased in by 2050, but its main implications will be felt starting in 2011.<sup>8</sup>

The current old age pension system in Germany consists of three pillars: the government-run Statutory Retirement Insurance System, corporate plans and private individual retirement investments, which include Riester pensions. In order to explain the foundation on which the Riester pension stands, the first two pillars of the German pension system will also be briefly introduced.

### **Pillar I: The Statutory Retirement Insurance System**

The German Federal Pension Insurance (Deutsche Rentenversicherung, DRV) continues to be the most important institution for old age income in Germany. About 80% of the workforce (in 2009 approximately 52.2 million people) is mandatorily insured by the DRV. A 19.9% portion of each worker's salary is paid into the public pension insurance system,  $\frac{1}{2}$  by the employer and  $\frac{1}{2}$  by the employee.<sup>9</sup> Currently, annual pensions paid are calculated as a maximum amount of 70% of an employee's average net annual earnings during 45 years of his/her working life, but will gradually decrease to 67-68% until 2030.<sup>10</sup> It is possible to claim the standard old-age pension upon reaching the minimum age<sup>11</sup> once a five-year general qualifying period of continuous contributions has been completed.

Approximately 89% of people 65 years of age and older (20.4 million in 2009) receive a monthly pension (an average of 739.63 Euros per month in 2009) from the DRV, which is considered the basic income pillar during retirement.<sup>12</sup>

The Statutory Retirement Insurance System also includes pensions for those with reduced earning capacity, available to employees with severe health problems, and surviving dependants' pensions, designed for widows/widowers and

orphans who lose income due to the death of a spouse or parent(s).<sup>13</sup>

### **Pillar II: Company Pension Plans**

The second pillar of the German pension system is company pension plans. Since 2002, employees are entitled to have part of their earnings paid into a company pension plan under a deferred compensation arrangement.<sup>14</sup> However, according to the German Federal Statistical Office, employees on average only invested 273 Euros (or 0.7%) of their annual gross income into company pension plans in 2008<sup>15</sup>.

### **Pillar III: Private Pension Plans**

In 2001 a new pension reform act was ratified in Germany, which meant a significant promotion of supplementarily funded private pensions. The so-called "Riester reform", as mentioned before, was created to fill the pension gap opened up by the growing old-age-dependency ratio and unavoidable future cuts in the Statutory Retirement Insurance System. Long overdue, it aimed at achieving sustainable contribution rates, securing the long-term stability of pension levels and expanding supplementary private pension savings. It also considered intergenerational pressure and is helping to keep the contribution rate to a maximum of 20% of salary until 2020 and below 22% until 2030. Private pensions are not mandatory in Germany and can be either occupational or individual. In general, private pension plans can be broken down into three types of investments: insurance policies (mainly life insurance), capital market products (stocks, bonds, etc.) and real estate.<sup>16</sup> The focus here lies on the state-subsidized Riester product range, which will be explained below.

### **Riester Pension**

The basic idea of the Riester pension is to use government subsidies as an incentive for people to secure their old age income with additional private old age provision. A simple but efficient certification system ensures the quality of the investment products. Before the Riester system's incentive and certification structure is explained, an overview of the target group as well as terms and conditions of the general Riester concept will be given. The Riester system's development and success, as well as its downfalls, will conclude this chapter.

### **Target Group**

The target group of the Riester pension includes those who will be affected most by decreasing public pensions: compulsorily insured employees, agricultural workers and civil servants. It also includes soldiers, people who receive unemployment or reduced earning capacity benefits and those who care for others at home. The concept especially aims at targeting households with relatively low incomes. Riester

<sup>5</sup> Statistisches Bundesamt 2009 p. 10

<sup>6</sup> Walter Riester headed the Ministry of Labour and Social Affairs from 1998- 2002 and was the main trailblazer for the reform process.

<sup>7</sup> It was named after the economist Bert Rürup, who acted as Chairman of the Commission.

<sup>8</sup> Börsch-Supan, Wilke 2006, p. 577

<sup>9</sup> Deutsche Rentenversicherung 2010, p. 1

<sup>10</sup> Honekamp 2008, p. 3

<sup>11</sup> To place the statutory pension insurance systems on a sustainable financial foundation, the minimum age for a standard pension in Germany is to be gradually increased from 65 to 67 by 2029 (Kommission zur Nachhaltigkeit in der Finanzierung der sozialen Sicherungssysteme 2003, p. 7).

<sup>12</sup> Brümerhoff 2007, p. 327, BMAS 2008, p. 12, BMAS 2010b, p. 15, 18, 19

<sup>13</sup> BMAS 2010a, c

<sup>14</sup> Deutsche Bundesbank 2001

<sup>15</sup> Statistisches Bundesamt 2010

<sup>16</sup> Börsch-Supan, Wilke 2006

pensions are not available to the self-employed<sup>17</sup> and employees who are not compulsorily insured, although self-employed persons can use the Riester system if their spouses are members of the income groups cited above<sup>18</sup>.

### Terms and Conditions

People who provide for their retirement with Riester have to invest at least 60 Euros per month<sup>19</sup> as a basic contribution. In order to receive government subsidies of 154 Euros per annum (308 Euros for married couples), a Riester saver has to contribute 4% of his/her annual income before taxes (but only to a maximum of 2,100 Euros) into his/her Riester account. If he or she has children, an additional 185 Euros or 300 Euros (for children born after January 1<sup>st</sup> 2008) can be received.<sup>20</sup> Alternatively, all Riester savings up to 2,100 Euros can be claimed as a special expense deduction in the worker's annual income tax return if that is more profitable for the Riester saver than receiving the subsidies. If Riester savers are not able to pay 4%, the government payout will be reduced to the percentage that can be paid into the account.

One prerequisite for receiving these government pension payments is to invest in a certified Riester product. According to the Riester regulations, bank savings plans, classical private pension insurance, unit-linked pension insurance, fund savings plans, pension funds or even direct insurance can be included in the range of Riester products if they fulfil the certification criteria. This range of products has developed over a time span of 10 years and the variety it represents can be viewed as an additional set of incentives.

Although the Riester pension plans guarantee that pensions are received, each Riester client still needs to compare different types of Riester pension plans and consider other forms of investment and saving (that may not receive beneficial tax treatment) to fit his or her individual needs and ability to make contributions.<sup>21</sup> In comparison to other savings options, such as life insurance, Riester savings cannot be pledged and do not have to be used up before their owners can qualify for long-term unemployment benefits or social assistance. But Riester assets cannot be accessed before the beneficiary reaches the age of 60, and the savings can only be inherited in a few cases.<sup>22</sup> The premature cancellation of a Riester contract means that all government benefits so far must be repaid. Therefore, Riester contracts are usually not cancelled before retirement. Due to the very strict government regulations, the certified Riester pension

plans are one of the safest options for old age savings in Germany.<sup>23</sup>

### Riester Incentive and Regulation Structure

The Riester pension has gone through quite a few changes in the ten years since its introduction. Not only has the range of Riester products been gradually expanded and its rules and regulations simplified, but more incentives for various income groups have also been created.

### Incentives

The savings subsidy, combined with a certain percentage of income saved, can be regarded as the most obvious and effective incentive. This percentage of income to be invested in order to receive government subsidies has been gradually increased. In 2002, government subsidies (38 Euros for singles, 76 Euros for married couples) were received by savers who contributed only 1% of their annual income before taxes, up to a maximum of 525 Euros. In 2004, 2% was required (maximum 1050 Euros, subsidies of 76 Euros/152 Euros); in 2006 it was 3% (maximum 1575 Euros, subsidies 114 Euros/228 Euros). Those who signed up for a Riester savings plan in 2008 now have to pay 4% of their annual income before taxes (maximum 2100 Euros) in order to receive the full government subsidy of 154 Euros for singles and 308 Euros for married couples.

The annual child benefit was increased from 46 Euros to 185 Euros per child for children born before January 2008 and 300 Euros per child born after January 2008 for as long as the parents receive child allowances. The child benefit is paid to the mother, but can be paid to the father at the request of both parents.<sup>24</sup>

Since 2008, any young professional has received a one-time bonus of 200 Euros if he/she signs up for a Riester pension plan before his/her 26<sup>th</sup> birthday.<sup>25</sup> One of the greatest challenges for a non-mandatory pension system is to encourage young people to start saving for retirement. Setting incentives for a young age group to start saving even a few years earlier can make a big difference when these savers receive their pensions later on.

Riester's incentive structure is attractive not only due to state subsidies, but also due to conceptual changes which have made the Riester pension gradually more attractive. Soon after the introduction of the Riester pension, a major change was announced regarding housing loans in 2002. A Riester saver was allowed to use 10,000-50,000 Euros for residential property in Germany. In 2008 this rule was extended to permit the use of the full amount of Riester savings for building loan contracts or for buying real estate. The real estate must be used directly by the Riester saver.<sup>26</sup> Since 2005, Riester savers have been permitted to receive 30% of their savings in a one-time payment at the time of

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<sup>17</sup> The Rürup Pension, introduced in 2005, provides a similar concept for old-age savings for the self-employed. For more information please see: [website](#)

<sup>18</sup> Riester Rente Info 2010b

<sup>19</sup> The average income in Germany before taxes was 32,003 Euros p.a. in 2010, calculated by the DRV (2011).

<sup>20</sup> Riester Rente Info 2010b

<sup>21</sup> A good overview of which Riester product fits whom can be found in: [website](#)

<sup>22</sup> The full amount of Riester savings can only be transferred to a spouse's account if the spouse has a Riester account. Children or other close relatives cannot receive the savings.

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<sup>23</sup> Honekamp 2008, p. 11

<sup>24</sup> Bundesministerium der Justiz (2009), Honekamp 2008, p. 5

<sup>25</sup> Riester Rente Info 2010b

<sup>26</sup> Honekamp 2008, p. 4

retirement. The rest must be received as a life-long monthly pension<sup>27</sup>.

With the Retirement Income Act (*Alterseinkünftegesetz*) of 2006, unisex pension calculation was introduced, which means that men and women now receive the same amount of pension for the same contribution amounts. Before the change, the pension was calculated according to sex-specific life expectancy. Due to the fact that women statistically have a higher life expectancy, they had to pay higher contribution amounts in order to receive the same level of benefits as men. Men now have to factor in 6.5% more for the level of benefits they would have received before the unisex calculation came into force.<sup>28</sup>

### Regulation System

In the Riester pension concept, consumer protection is very important. For this reason, the state supervises the Riester pension and all investment products. Strict and monitored minimum requirements have been stipulated by the government and certification criteria have to be met by any investment product that carries the name “Riester”. The Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) is responsible for the certification process to determine whether an investment product fulfils all the certification criteria. With this certification system, the government wants to make sure that only safe and proven Riester products are available on the market. Only certified investment products are subsidized by the state. Thus, the Riester pension certification system provides comprehensive consumer protection.<sup>29</sup>

In order to receive a certificate for a Riester product, financial providers initially had to comply with a total of 11 conditions. In 2006, these conditions were changed to six rules to make it easier to understand and comply with certification requirements.<sup>30</sup> Riester products receive government certification when they comply with the following criteria:

- A minimum payout corresponding to the full disbursement of contributions and government subsidies in a life-long pension payment is guaranteed.
- The pension contracts have to be gender neutral.
- The payment of the private pension cannot start before the participant reaches 60 years of age.
- The Riester pension provider also has to make sure to use transparent terms and to inform his clients about all fees, costs, risks and different options of annual rates of return.
- Riester pension providers must also spread new business and distribution costs over a time span of five years.
- The contracts can be cancelled or temporarily suspended as of the end of any quarter, but cannot be pledged.<sup>31</sup>

### Critique of the Riester concept

Nevertheless, there are a few points of critique that also should be mentioned. Due to the very short time of experience with Riester pensions, some voices in the public debate still criticize the three-pillar concept. Nor is it undisputed whether the Riester products manage to reach enough people and achieve the goal of stabilizing contribution rates for younger generations. Therefore, DIW proposes to systematically review and revise the concept and the Riester pension itself. The main points of critique are the following:

- The question has been raised as to whether the Riester concept, with its state subsidies, is a violation of market economy regulations because it constitutes an unfair advantage over other savings options, thus limiting competition.<sup>32</sup>
- Demographic and economic assumptions and calculations made to help the Riester reform pass in parliament were overly optimistic, and the promise to stabilize the contribution rate can probably not be kept despite the efforts made by the Riester system.<sup>33</sup>
- It was calculated that the Riester pension might actually be more expensive, inefficient and socially unfair than a pure pay-as-you-go system. For 2030, a contribution rate of 24% (half of which is paid by the employer) into the statutory pension fund has been calculated as a realistic reform to finance pensions. The Riester reform set a limit of 22%, supported by 4% of private pension funds, which amounts to 15% for the employee and 11% for the employer<sup>34</sup>.
- Furthermore, it has been argued that low-income earners who cannot afford to put aside 60 Euros per month are, with their taxes, indirectly helping to pay for the Riester subsidies which are also received by high-income earners.<sup>35</sup>
- The large number of Riester contracts is only a success upon superficial observation because, in many cases, money was withdrawn from other saving options and transferred to a Riester account to take advantage of the state bonus. Such accounts cannot be calculated as new savings accounts for old age and mainly benefit high income groups (crowding-in effect).<sup>36</sup>
- Contributions for health and nursing care insurance are paid twice: once when contributing and once when receiving the pension.<sup>37</sup>
- There is no accident/disability option in private pension plans, and time spent to raise children is not calculated into private pension plans.<sup>38</sup>

### Development and Success of the Riester concept

After the Riester pension was introduced, a steady increase in members with signed Riester contracts was noted in the first two years. However, after the first run, numbers of

<sup>27</sup> Honekamp 2008, p. 4

<sup>28</sup> Riester Rente Info Portal 2011

<sup>29</sup> Altersvorsorge-Riester-Rente.net 2011

<sup>30</sup> Honekamp 2008, p. 4

<sup>31</sup> BaFin 2007, Riester Rente Info 2010a

<sup>32</sup> Corneo et al. 2007

<sup>33</sup> Börsch-Supan, Wilke 2006

<sup>34</sup> Schmähl 2009; Schmähl 2005

<sup>35</sup> Schmähl 2009

<sup>36</sup> Corneo et al. 2007

<sup>37</sup> Hoyer, Gerth 2009

<sup>38</sup> Schmähl 2005

signed Riester contracts started to slow down. Studies showed that the Riester product was too complicated to understand, and only 72% of the eligible beneficiaries even knew that they were entitled to “riester”. In 2008 only 32% of the calculated number of people eligible for Riester had a contract.<sup>39</sup> With the major change in 2005 to simplify the procedure, the acceptance among the population rose, and the number of Riester accounts increased again. Since Riester and other saving systems require basic financial knowledge, DRV and its partners offer free classes nationwide to help people find the best solution for their financial security after retirement.<sup>40</sup> In spring of 2009, the number of total Riester contracts signed accounted approximately 12.5 million.<sup>41</sup> It is interesting to note that mostly women from the eastern part of Germany have decided to invest in Riester. Of the female contributors, 2/3 received the child bonus, which might also be the reason for the high interest in Riester products among women. The German Institute for Economic Research (Deutsches Institut für Wirtschaftsforschung, DIW) calculated that Riester savers with an average income below 10,000 Euros p.a. accounted for only 14.5% of the total number of Riester savers, but was the only income group that tripled their number of contracts from 2005-2007.<sup>42</sup> It has also been noted that especially members of younger generations make use of Riester products. All in all, it has to be acknowledged that the Riester pensions’ set of incentives works quite effectively as the numbers above show. And Riester’s success is obvious not only from the numbers, but also from the fact that low-income groups, such as women with children and young people saving with Riester, show very positive results.

### National Pension System – Swavalamban Yojana

In India, the New Pension System (NPS) was formally introduced on 1 January 2004. Initially it operated as the mandatory defined contribution scheme for new employees of the central government, but was quickly extended to the new employees of those union states which had decided to join. Since May 2009 NPS has also been open for voluntary registration by unorganised sector workers.<sup>43</sup>

The current NPS system can be divided into two schemes, NPS and Swavalamban Yojana. The main difference between the two schemes is that they serve different income groups – the formal (NPS) and informal sectors (Swavalamban Yojana) – and terms and conditions are adjusted to each sector’s needs.

Swavalamban Yojana is split again into NPS Unorganised Sector and NPS lite. Both sub-schemes were especially designed for the informal sector and target the economically disadvantaged sections of society. NPS Unorganised Sector serves as an individual pension scheme, while NPS lite is a group pension scheme designed to include existing pension systems from welfare boards, microfinance institutions and

other group aggregators. NPS lite is also meant to reduce transaction and administration fees via group processing for low-income workers who can only make small contributions.<sup>44</sup>

### Terms and Conditions

Indian citizens aged between 18 and 55 can subscribe to the scheme. Each member of NPS receives a Permanent Retirement Account Number (PRAN) that remains the same for the rest of his/her life. The account and the account number are transferable throughout the country and can be accessed from any location in India. NPS accounts can be opened at Points of Presence (POPs), which include post offices and bank branches. The subscriber is required to make his/her first contribution at the time of applying for registration at any POP.<sup>45</sup>

Assuming that an NPS Unorganised Sector subscriber makes monthly payments into his/her account, his/her annual payment - after paying Rs 90<sup>46</sup> to open an account - is between Rs 592 and Rs 772 plus 0.0075% and 0.05% for asset service charges and the investment management fee respectively.<sup>47</sup> In comparison, a NPS Lite subscriber’s annual payment is between Rs 70 and Rs 250 plus 0.0075% for asset service charges and a 0.0009% investment management fee – a considerable cost reduction compared to the NPS Unorganised Sector rules.<sup>48</sup>

Depending on age at withdrawal from the pension account, the following benefits are available:

- At any point in time before 60 years of age: The subscriber is required to invest at least 80% of the pension wealth to purchase a life annuity from any regulated life insurance company. The remaining 20% may be withdrawn as a lump sum.
- On attaining the age of 60 years and up to 70 years of age: The subscriber is required to invest a minimum of 40% of the accumulated savings to purchase a life annuity from any regulated life insurance company. The remaining pension wealth can be withdrawn either in a lump sum upon attaining the age of 60 or in a phased manner between the ages of 60 and 70 at the discretion of the subscriber.
- Death due to any cause: A beneficiary will receive 100% of the pension wealth in a lump sum.<sup>49</sup>

### Incentives

Conceptually, NPS has established itself as the dominant new approach for old-age provision in India and has been welcomed with a great deal of positive anticipation by formal sector employees. In practical terms, however, the implementation of the scheme has been progressing slowly, especially regarding the numbers of participants from the informal sector. To create an incentive for informal sector

<sup>39</sup> Leinert 2003, p. 3

<sup>40</sup> Please see: [website](#)

<sup>41</sup> Geyer, Steiner 2009, p. 534

<sup>42</sup> Geyer, Steiner 2009, p. 539

<sup>43</sup> PFRDA 2011

<sup>44</sup> PFRDA 2010, pp. 2-5

<sup>45</sup> PFRDA 2010, p. 18

<sup>46</sup> Approx. 1.42 Euro (as on 31 March 2011)

<sup>47</sup> PFRDA 2010, p. 251

<sup>48</sup> PFRDA 2010, p. 28

<sup>49</sup> PFRDA 2010, pp. 25-26

workers to join NPS, the Indian Government committed to contributing Rs 1,000 per year for the next three years to each NPS Swavalamban Yojana account opened until 2011. The benefit of Rs 1,000 per year is only available to persons who join NPS with a minimum contribution of Rs 1,000 and a maximum contribution of Rs 12,000 per annum. There is as yet no official commitment that these subsidies will continue beyond the currently stipulated time frame.<sup>50</sup>

### Regulation System

The Pension Fund Regulatory and Development Authority (PFRDA) has been mandated by the Government to establish, develop and regulate NPS. In particular, it is responsible for supervising the Pension Fund Managers (PFMs) and the Central Record-Keeping Agency (CRA).

The National Securities Depository Limited (NSDL) has been appointed as the Central Record Keeping Agency (CRA). The record-keeping, administration and customer service functions are centralized. NSDL is in charge of issuing PRANs, collecting customer data and providing annual account statements and all other relevant information via modern technical devices (SMS, online account). CRA also monitors the administrative aspects of those institutions (called aggregators) that co-operate with NPS to help their constituencies gain access to NPS, and handles grievances.<sup>51</sup>

### Lessons to be learnt from the Riester Pension System

Considering the fact that the Riester pension system has developed and expanded its range of products and incentives over a decade, while NPS Swavalamban Yojana is still in its infancy, the following lessons learnt from Riester might provide NPS with a few ideas on how to continue to develop methods to make saving for old age even more attractive for low-income groups.

**Incentives:** Both Riester and NPS Swavalamban Yojana work with financial incentives. However, one significant difference between the Indian NPS system and Riester is that the German government's incentive is measured in percent rather than real amounts. This also provides reduced incentives for savers who are not able to provide the entire 4% of their income, but supports them in saving up to this percentage. Secondly, the Riester subsidies are not time limited and also include child benefits. Thus, the German approach not only focuses on having people subscribe to the scheme, but also provides incentives such as child subsidies that keep the scheme very attractive even after a number of years. As the numbers show, the child bonuses in the Riester pension programme are effective in reaching the female population as new Riester clients. Also, the young generation has constituted quite an increase in new Riester savers, which can partly be traced back to the 200 Euro bonus as mentioned before.

**Terms and Conditions:** Pension systems should aim to include a great variety of different groups of people: young, old, men, women, families, working (formal and informal) population, unpaid domestic workers, widows, orphans, pregnant women and people with health problems. In order to make a pension system attractive and adaptable, terms and conditions need to fit the individual needs of various groups. Apart from the classical pension insurance scheme, other long-term saving options need to be considered. This gives both late and early savers a variety to choose from. Variety should also include flexibility between the different products, because people's saving ability may vary during their lifetime. For some, partly investing in real estate might be easier to relate to than a pension account and could also serve as an incentive to start to save with NPS.

Putting the Indian system in a time frame, the regular NPS model was presented in 2004, NPS Swavalamban Yojana was introduced in 2009 and NPS lite in 2010. After NPS was introduced into the formal sector, the Pension Fund and Development Authority first aimed at expanding pension products to the informal sector.<sup>52</sup> The next step for NPS will probably lead into diversifying their range of products.

Provision should be made for women who are not able to earn, and therefore save, as much as others due to pregnancy or taking care of children. Also, accidents and death of the client create situations that need to be considered in pension systems. A phase in which clients can defer their contribution for a certain amount of time takes pressure off of them and can keep them from dropping out of the system. Furthermore, in India, female life expectancy is higher than that of males, and women seldom pay into a pension account of their own. Gender-specific changes might be appealing and could encourage female savers to open up their own account.

**Quality and consumer protection** is essential when it comes to long-term saving. Clients need to know that their savings are secure in a system that is able to survive economic crises. Quality is especially important at the front end where there is consumer contact. A certification system for distributors of pension products can create trust among the population and ensure that information is relayed correctly. The Indian Pension Fund and Development Authority (PFRDA) has released various statements, guidelines and operational procedure forms on how the system is supposed to function; however, there seems to be no comprehensive quality management system specifically for NPS Swavalamban Yojana as yet.<sup>53</sup> Contributors will have questions not only regarding the system, but also regarding how the so-called Points of Presence or Aggregators are selected and whom they are entrusting with their savings. Due to the fact that especially the front end of the system has close contact to the contributors, a state-supervised certification system for NPS's product range and distribution system would not only provide assurance of high quality and trans-

<sup>50</sup> PFRDA 2010, pp. 2-5

<sup>51</sup> PFRDA 2010, pp. 18, 26-27

<sup>52</sup> PFRDA 2009

<sup>53</sup> For further information, please see: [website](#)

parency, but also create trust among savers and potential future savers.

**Information:** It is important to raise awareness of financial security for old age. Information about non-traditional saving options needs to be conveyed in an understandable manner, as do the reasons why it is so important to start saving for old age when still young. After this first step, pension products have to be explained. Due to their very complicated nature, it is essential to provide room for questions and comments. This can only be done in seminars, meetings or other face-to-face opportunities. Especially people with little financial background need to be able to understand the rules and regulations. NPS clearly needs to focus on providing potential savers not only with flyers of the schemes, but also with information material on why it is important to save for old age in general and what benefits NPS provides in comparison to traditional saving schemes. This very basic set of information has to target all age groups, but especially focus on and raise awareness among the younger generations.

## Outlook

The challenge of creating an inclusive, affordable and fair pension system is immense, but as the German system shows, possible. Structures, terms and conditions constantly need to be revised and adapted to economic, cultural and demographic changes. Within its 10 years of existence, the German private pension pillar alone has gone through several modifications and more are in the pipeline.

The incentive structure created for the Riester scheme makes it very attractive to invest savings in Riester products. Due to the fact that a pension product is not confined to short-term contracts but continues for decades, Riester not only provides incentives to start saving with the product, but also stays attractive throughout various life cycle events, such as having children and making real estate investments. Trust is essential when it comes to old age savings. Money that is saved for such a long time and for a goal so far in the future has to be invested in a trustworthy product. The Riester certification system, constantly revised and adjusted, aims at providing full transparency and high quality.

The extensive and heated discussions about the end of the pure PAYG system and the introduction of the Riester pension had one major effect: The problem of insufficient financial provision for younger generations when they reach old age came to be recognized by the German population. Due also to extensive media coverage, people started to realize that the amount of the public pension they will receive after retirement will probably not be sufficient to financially secure their old age. Before the debate, the security of the PAYG system gave people a good reason not to bother with this complicated topic that addressed an issue far in the future. As the numbers show, people who had been paying into the state-run system actively started finding complementary solutions. Thus one of the main barriers - making people aware of possible financial problems during old age - was eliminated. In India, such heated debate, espe-

cially among informal sector workers, is missing. The Government of India will have to find solutions that raise awareness of the importance of saving for old age. Information and quality are important, but a smart incentive structure, in financial and conceptual terms, might serve as the ultimate reason for not only formal but also informal sector workers to sign up for NPS. It can be hoped that the same positive results as those of the Riester scheme in Germany can be achieved.

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The paper is intended to contribute to the debate and offers  
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