



NPS pension payouts to become flexible

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- The pension regulator is working on alternatives to the mandatory annuity products that NPS subscribers have to buy from insurance companies
- PFRDA may introduce systematic withdrawal plans from NPS or float its own annuity product

Topics

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The Pension Fund Regulatory and Development Authority (PFRDA) is working on alternatives to the mandatory annuity product that National Pension System (NPS) subscribers have to buy on exit. When exiting on maturity, NPS subscribers can withdraw up to 60% of the corpus but compulsorily need to buy an annuity plan with the remaining 40%. For premature exit after 10 years, 80% of the corpus needs to be annuitized.

There are two proposals in the works at [PFRDA's](#) table. "Subscribers told us that they have been getting over 9% returns during the accumulation phase. But on retirement, the returns in an annuity plan work out to be much lower—in the range of 6-6.5%. We, therefore, decided to offer more options in addition to the existing annuity plan," said Supratim Bandyopadhyay, chairperson, PFRDA.

Currently, NPS Trust has seven empanelled insurance companies offering annuity products. A subscriber can opt for an annuity for life, or annuity for a limited period like 10-15 years, or annuity for life where the annual payout increases every year by a fixed percentage. Annuity products have been unpopular as the rates they offer are usually low and fixed upfront for life. Also, the payouts are taxed in the hands of investors.

Annuity options

Option 1: The first is introducing a systematic withdrawal plan (SWP). Instead of buying an annuity, subscribers can opt for SWP. Typically, in an SWP, an investor gets to withdraw a fixed amount every month from an accumulated corpus. The rest remains invested.

As of now, SWP is a facility that mutual funds provide and is more tax-efficient for those in the highest tax bracket. The long-term capital gains (LTCG) tax for equities is charged at 10% if investments are redeemed after a year. But if the total gains are less than ₹1 lakh in a financial year; there is no tax. In case of a debt fund, LTCG tax is charged at 20% with indexation benefit if an investor withdraws after three years. If SWP in NPS is indeed announced, the taxation rules will be notified by the Central Board of Direct Taxes later.

PFRDA is working on the details on the structure. "The money will remain in the system and subscribers could get better returns than what annuities offer at present," said Bandyopadhyay.

In the past five years, central and state government NPS have given annualized returns of above 8.7% (the minimum among all pension fund managers), according to data from Value Research. The corporate CG (central government) scheme gave above 8.8%. Private NPS has three funds where the returns from government bond funds is over 9% for five years, corporate debt funds have returns over 9% and the equity funds over 5.2%.

Option 2: Under this, PFRDA may announce its own annuity plan. According to Bandyopadhyay, it could be a variable annuity plan where the payout could be linked to a benchmark and would vary as per the benchmark interest rate. This mean, the payout would depend on the performance of the investments. "Annuity as a product comes under Irdai. But if PFRDA is set to become the regulator for all pension products, we need to see how the regulations would work because of the prevalence of multiple regulators." said Amit Gopal, principal, Mercer Consulting India, a human resource consulting firm. Gopal also pointed out that insurers find it difficult to price an annuity product. Pricing variable annuity could be more difficult if the subscriber wants a minimum payout, he added.

At present, both the proposals are in the development stage. “The government has agreed to look at our proposals. But we need to put a structure to it and then seek approval from the government,” said Bandyopadhyay.

What this means for you

More options will help subscribers plan their retirement better and will encourage more individuals to enrol in NPS. According to financial planners, if multiple options are introduced, PFRDA should allow subscribers more flexibility in choosing how much to buy an annuity for.

Typically, buying an annuity product takes away two risks—reinvestment and longevity. It’s difficult to predict the interest rates. This product locks the interest rate at the beginning, protecting the investor from any reinvestment risk. Also, it provides lifelong pension, so longevity is not a challenge. “The new options that PFRDA wants to introduce would not cover reinvestment risk. Returns in both the options are market-linked,” said Deepesh Raghaw, a Sebi-registered investment adviser based in Mumbai.

Some financial planners prefer to keep only a small amount of the retirement corpus in annuity. “Usually, if an individual manages an adequate corpus for retirement, we keep 10-20% in annuity,” said Vishal Dhawan, founder, Mumbai-based Plan Ahead Wealth Advisor, a financial planning firm.

There is still no clarity on how these two options will be structured, the kind of restrictions they will have, and the choices subscribers would have. However, NPS remains one of the recommended products for retirement planning.