

Auto or active investment: Which option is better for NPS?

Active choice option: You can decide asset allocation on your own across equity, bonds (government or corporate), and alternate investments

2 min read Updated: 21 Jul 2022, 06:13 AM IST Navneet Dubey



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The National Pension System (NPS) allows subscribers to invest in various asset classes such as equity, corporate bonds, and government securities through two options: active choice or auto choice. Yet, it can be challenging for subscribers to zero in on the right option that is suitable for them. This piece will help you understand the difference between the active and auto-choice options under NPS.

Active choice option: You can decide asset allocation on your own across equity, bonds (government or corporate), and alternate investments. However, the maximum allocation to equities is limited to just 75%. Under this option, every pension fund manager will offer a list of schemes that you can choose from as per your preference.

Auto choice option: The NPS automatically allocates the fund and assets on behalf of the subscribers if they choose this option. This allocation process uses a life-cycle-based approach for the allocation. It starts with providing a higher exposure in the equity portfolio when you are young and reduces the equity exposure as you age and get closer to retirement.

This allocation approach optimizes returns and protects you against market volatility and risks.

There are three funds to choose from under an auto allocation choice: A Moderate Life Cycle Fund is a default option that keeps the maximum equity exposure to 50%. The Conservative Life Cycle Fund, which caps the maximum equity allocation to 25% and works conservatively. The third is an Aggressive Life Cycle Fund that caps maximum equity exposure to 75%.

Active or auto option?

It may be difficult for a subscriber to choose between the options when they start investing in NPS.

Ajit Kumar, chief strategy officer, KFinTech, said, "If you are confused about which investment option to begin with, then the auto allocation option may be a good choice. This option can help subscribers spread their contribution across the available assets evenly. However, you must opt for the NPS active choice when you gain enough knowledge and understanding of the markets and the system and have the confidence to manage your portfolio independently."

Vishal Dhawan, founder and CEO of Plan Ahead Wealth Advisors, explained, "Subscribers should consider looking at three factors if they want the active choice. The first factor is the ability to make decisions on asset allocation choices depending on valuations of different asset classes or access to investment advice. The second is the investors' asset allocations elsewhere via other platforms, as the NPS would only be a subset of the investor's overall portfolio. For instance, if the investor has a debt-heavy portfolio elsewhere, he may choose to have more equities in the NPS and hence not want an auto option. Third is the time needed to review the NPS portfolio on an ongoing basis to make active choices and switch where needed."

"Basically, to make an active allocation choice, you will have to be an aware and hands-on investor following all relevant market dynamics on your own. With this domain expertise, you can fully control your NPS investments," added Amol Joshi, founder of Plan Rupee Investment Services.

Point to note

In Active Choice, non-government subscribers can retain a 75% equity allocation till they retire. However, there is an automatic taper in the equity allocation after the age of 50 for auto-choice, including in the aggressive plan.