EPF scores over NPS

For retirement solutions, financial advisors prefer sticking to a combination of EPF/PPF and equity mutual funds

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ILLUSTRATION: BINAY SINHA

Bangalore-based Dirk Lewis, 30, who works for a leading information technology services company, plans to subscribe to the National Pension System (NPS) from the next financial year (2014-15). His company offers the NPS option to its employees, over and above the mandatory Employees' Provident Fund (EPF) provision.

"NPS would help me save more on the tax front. Also, knowing myself, I would save only when I am forced to. This way (through NPS), I would be able to build a neat corpus for my retired life. I have some expenses this year, which wouldn't allow me to contribute towards NPS," says Lewis.

A host of companies, including Infosys, Wipro, Reliance Industries, Muthoot Finance, Colgate-Palmolive, Capgemini and Pantaloons, offer the NPS option.

Samir Gadgil, general manager and global head (compensation and benefits), Wipro, says the company has been seeing good traction from employees interested in NPS, over and above EPF. "On an average, annual contribution stood at ₹4-6 crore. And, the number of employees subscribing to the scheme is growing on an annual basis," he says.

Wipro recommends NPS for product diversification, as well as a substitute for voluntary contribution towards EPF, Gadgil says.

Some companies say primarily, those in the 30-35 age bracket are subscribing to NPS, as they are aware the product's equity component could deliver good returns through 30 years.

George Alexander Muthoot, managing director of Muthoot Finance, feels NPS would help his employees build a decent retirement fund.

A company can either offer investment options at the subscriber level, allowing employees to choose the pension fund manager and the asset allocation (active choice), or at the company level, in which case the company decides the fund manager and the asset allocation (auto choice). Under the latter, the company may opt for the portfolio mandated for central government employees and choose from the three government fund managers — LIC Pension Fund, SBI Pension Fund and UTI Retirement Solution — or from schemes and fund managers for the voluntary sector.

All one has to do is subscribe to NPS and ask his/her employer to deduct a fixed amount every month or year. Many companies also contribute towards their employees' NPS and get tax benefits under Section 80CCE by terming this business expenditure in their profit-and-loss accounts. Even the employer's contribution of up to 10 per cent of basic and dearness allowance is eligible for deduction, though such employers later deduct their contribution from the employee's salary. Most companies ask for an annual contribution of at least ₹6,000 (once a year), or at least ₹500 a month. Many companies have spread awareness on NPS among employees through web seminars, group discussions and helpdesks at their campuses.

Financial planners, however, aren't too enthused by NPS (compared to EPF), though comparing the two isn't fair—while EPF is purely a debt product, NPS also invests in equity. Certified financial planner Arnav Pandya feels EPF is meant for those who do not understand investment very well—they simply put away money in EPF and earn handsome returns. NPS, however, is meant for those who have a fair knowledge on investment and can choose funds. "NPS is a product that should figure in the list you consider for investing for your retirement, whether you put money into it or not," he says.

For Mumbai-based certified financial planner Gaurav Mashruwala, in their current forms, EPF scores over NPS, a view shared by Sumeet Vaid of Freedom Financial Planners.

"Simply put, EPF is slightly market-driven to the extent of investing in government securities, while NPS is about 50 per cent market-driven, due to the equity component. As a result, returns are safe in EPF, not in NPS. There is a small cost attached to investing in NPS, but there is no cost in investing in EPF," says Mashruwala.

Also, NPS has withdrawal limits; EPF does not—it offers premature withdrawal for specific purposes (house construction, marriage and illness), without foreclosure. Any premature withdrawal leads to account closure in the case of NPS. Up to 20 per cent of the funds can be withdrawn from NPS before one turns 60; the rest has to be used to buy annuity. Also, you can easily stop contributing towards EPF in desperate times; you can't do so with NPS.

"One NPS fund manager I met recently told me they don't make money on NPS asset management; they hardly rejig the portfolio on the back of market conditions," says an industry expert. If fund managers aren't paid adequately, returns may soon start declining. The expert, therefore, feels the government should look at developing the product to make it more investor-friendly.

Also, NPS returns aren't very attractive. The Employees' Provident Fund Organisation (EPFO) gives 8.5 per cent returns to subscribers. Till August 2012, returns offered by NPS stood at 6-11 per cent (an average of 8.5 per cent). Though NPS should give better returns (compared to EPF) due to the equity component, this hasn't been the case. Therefore, it hasn't appealed to investors or financial advisors. Vaid says many company trusts that manage EPF money on their own have delivered higher returns — 9-9.5 per cent. Therefore, it might not be sensible to consider NPS.

Like Lewis, most look at NPS from a tax-saving perspective. Even then, the product doesn't seem lucrative. An employee's contribution of only up to 10 per cent of the basic and dearness allowance is eligible for deduction under Section 80CCD (this amount is within the ₹1-lakh limit, under Section 80C). Most taxpayers exhaust a substantial part of the Section 80C limit through EPF contribution, which can be invested up to ₹1 lakh, completely tax-free. Hence, contributing to NPS is hardly of any use, as long as you are an indisciplined investor and need to be forced into investing. A withdrawal from NPS is taxable at the slab rate and so is the annuity to be earned after retirement.

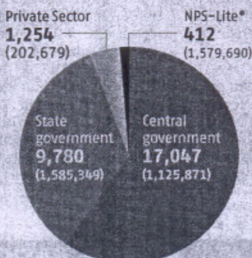
Therefore, Mashruwala advises sticking to EPF or Public Provident Fund (PPF), which offer annual returns of 8.7 per cent, and taking the equity-oriented balanced fund route to add equity to the retirement portfolio. According to mutual fund rating agency Value Research, equity-oriented balanced funds returned about seven per cent in the past year.

Financial experts feel for self-employed individuals, too, PPF scores over NPS, as investments of up to ₹1 lakh in PPF are completely tax-exempt.

While Gadgil says an employee can continue using his NPS account even after quitting an organisation, Vaid is doubtful about whether an employee would be disciplined enough to continue investing on his own, as the organisation he joins next may not offer NPS. He says, "Servicing is better when a product is offered by an organisation. This might not be true for independent NPS accountholders. NPS' product structure might not be easy to understand for most." He recommends a combination of EPF/PPF, debt funds and index funds. In the past year, the BSE Sensex returned about nine per cent, while the National Stock Exchange's Nifty gave eight per cent returns. From a tax point of view, too, equity is very efficient—if held for more than a year, returns from equity investment are tax-free in the hands of investors. Across categories, debt funds have returned 9-11 per cent higher than NPS. Also, if held for more than a year, debt funds get indexation benefits.

THE SCENARIO

Corpus under National Pension System (₹ crore) till March 2



Total: ₹28,493 crore (4,493,589)

Figures in brackets show number of subscribers

*Works on ultra-low admin and transaction costs, to make such small investments viable

There are some 16 crore EPF accounts of which around 4 crore are currently active, 4 crore of the inactive accounts are inoperative

Source: PFRDA

DIFFERENCE BETWEEN NPS AND EPF

National Pension System	Employees' Provident Fund
Voluntary retirement savings scheme	Mandatory retirement savings scheme for the salaried
For all individuals	Only for the salaried class
Contribution up to 10 per cent of basic + DA allowed deduction, inclusive in section 80C limit of ₹1 lakh	Contribution towards EPF is tax exempt (up to ₹1 lakh) under the Section 80C
Withdrawals taxable at slab rate organisation	Withdrawals taxable if not completed five years in an
Invests up to 50 per cent of the corpus in equity market	Does not invest in equities
Should give better returns than EPF; returns not guaranteed	Interest rates fixed every year, guaranteed
Limited premature withdrawal allowed but taxable, leads to account closure	Premature withdrawals allowed before maturity, without foreclosure
Account can be closed only after the age of 60	No restrictions ; complete withdrawal allowed on certain grounds
Cost levied on investment*	No cost involved

*NPS charges fund management fee of 0.0102 per cent for government employees and 0.25 per cent for private sector