A pension scheme for (part of) the private sector in Nepal

The Dutch NGO Diyalo urgently needs a pension provision for its personnel. This is an exploratory note how to come to a pension scheme. Annual income of the Diyalo-workers ranges from about Nrp 25,000 to Nrp 100,000 (or € 239 to € 956) with an incidental higher income.

1. Main characteristics of the scheme

The projected pension scheme for part of the Nepalese private sector aims to provide its participants a pension payment upon retirement age or to their survivors upon death of the member of the scheme. The financing of the scheme is based on the defined contribution principle. The pension function is realised by personal pension saving accounts with pooled asset management. A pension capital is built up during the working period which makes possible to provide the participants to the scheme a lumpsum pension payment upon a particular retirement age. Contributions as a percentage of income are paid by the employers and employees in any combination (e.g. 50 percent each), thereby committing both employer and employees to the fund. In practice employers of NGO’s mostly will receive additional financial means from the (foreign) sponsor enabling them to increase employees’ income. The increase or surplus of employees’ income is used for pension saving purposes. To operate the scheme cost-effectively the minimum number of participants in our view amounts to about 10,000 persons. To realize that number the fund will be open to any employer with at least 5 to 10 employees.

2. Governance

We propose a foundation according to Nepalese law as the legal vehicle for the pension fund with a Board of governors ex equo consisting of employers, employees/pensioners or their representatives, and chaired by an independent professional. The chairman is chosen by the members of the scheme. Apart from the Board there must be a supervisory body that for assessment purposes also appoints an auditor. We assume there is also any role in the control/governance cycle for the Nepalese Central Bank and/or the Ministry of Finance.

3. Participants to the scheme

A major group of participants to the scheme are the employers who offer their employees a pension provision on a personal basis by means of system of personal pension savings accounts. The operation of the scheme, collecting pension contributions, paying out the saved pension money to the elderly and investing the pension money are carried out by the pension fund. Employers can be independant companies, associations of employers in a particular

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From a practical point of view it is recommended to pay out the amount of pension savings in 5 to 10 yearly terms.
sector or industry (like the tourist sector, private health care, retail sector, etc), NGO’s etc. It is still to be considered whether self-employed workers can also join the fund. Another group of participants are the employees or former employees associated with employers who have or have had a contract with the fund. Employers can terminate their contract with the fund with a one year notice. Employees can terminate their contribution at any moment but are generally not allowed to withdraw their pension savings before the retirement age. The identification of beneficiaries is an important issue to solve. A finger-print (thumb-print) suffices.

4. Contributions

As observed contributions as a percentage of income are paid by the employers and employees in any combination. To realize a sufficient and satisfactory pension lumpsum payment in general we have to think about contribution payments of, say 10 percent or more of income during 25 to 30 working years, leading – with given 4% real interest rate – to a lumpsum pension result of 5 to 7 times average yearly income. The magnitude of the saved pension capital after that period of contribution payments however mainly depends on the capital returns on the pension savings. The rate of capital return appears to be very volatile and hence, difficult to project. It should be possible to pay extra or additional amounts of money for pension purposes. Contribution payments less than 5 percent of income are not significant and therefore not allowed. Not considered are old-age pension payments originating out of the state pension system (social assistance) and/or other pension savings with insurance companies. Most likely they are of minor importance. The contribution payments have also to cover the cost of operating the fund, e.g. administration of all the personal saving accounts, collecting contributions, paying out the pension money, asset-management, governance, training of personnel, communication and informing the participants, etc.

At the start of a pension scheme for a NGO-Diyalo the number of participants probably will not exceed 100 persons. As soon as possible that number has to be raised to about 1000 persons.

5. Benefits

The pension result or the amount of lumpsum pension capital that can be paid out at the time of retirement depends on the amount of yearly contributions, the contribution period, the operational costs, the tax burden, but above all the investment returns. Preferably the lumpsum payment at the time of retirement is used to buy an annuity pension that yields the pensioner a yearly pension payment till death. However, a well functioning market for annuities does not exist in most or all developing countries and in many developed countries as well. Hence, a lumpsum payment is the common standard in most countries of the world. Also portability of accrued pension rights is not taken into account. When the working member passes away before the age of retirement at least the amount of pension savings at date are paid out to the named survivors. A life insurance system paying out a lumpsum to the survivors/heirs at the time of death of the member irrespective how many contributions are paid at date is far more complicated as there are risk elements involved. Hence, that type of insurance is still under study. As a principle the retirement age is flexible but should not be below 60 years of age.

2 Only the ‘Life Insurance Company of India’ provides annuities in the Indian subcontinent, but probably at high costs.
6. **Administration, bureaucracy and operational costs**

To avoid excessive and expensive costs of administration as well as unnecessary bureaucracy the administration of the fund is as far as possible integrated with the financial and manpower management of the employers that joined the pension fund. In the first place the employers are responsible for collecting the contributions and transfer them to the pension fund. Also a major part of communication and information can be fulfilled by the employers or their association. Clearly the employer needs the help of the pension fund to promote pension awareness, and to expose the basic relationships between pension result (amount of lumpsum payment) and contribution payments, length of period of contribution payments and investment revenues. Conversely, the pension fund needs the support of the employers in many aspects.

To avoid fraud and/or other suspicious performance and behaviour the management of the pension fund is rigorously separated from the participating parties, employers and employees. Needless to say that confidence is extremely important.

7. **Asset management**

A main task of the pension fund under consideration is to invest the pension money in profitable assets. After experts’ consultation and broad discussion in the Board of Governors it is decided whether investing will take place and to which extent outside Nepal (: in USD or Euro) or inside Nepal: a) microcredit with the help and by means of a savings and microcredit community based organization (in NRp) and b) investing via the Acme-bank in Nepal (in NRp or other currency). The participating workers as a rule are not asked for their preference of an investment portfolio, how their risk profile looks like, etc. Unless they firmly express to wish so, which is highly unlikely (as in western countries).

8. **How to continue**

A financial grant would be helpful to start a pension scheme for NGO’s, etc in Nepal and to meet costs during a transional period. Under consideration (summer 2009). An operational system in Excel (probably) suffices to run the scheme as only personal saving accounts have to be administered. Next, instruction of Nepalese clerical staff and learning how to communicate. Furthermore see Appendix 2.

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Appendix 1. social security in Nepal

From ‘Social Security Programs throughout the World: Asia and the Pacific(2006-2007) ’ we derived the next review of the Nepalese social security system, old-age, survivors and disability benefits.

Type of program: (1) provident fund and (2) social assistance

Provident fund: Compulsary for civil servants and voluntary for any organization with 10 or more employees. Self-employed persons are excluded;
Employers pay 10% of monthly payroll (additional payments are allowed);
Old-age benefit (lumpsum equal to total contributions plus investment revenues; 5.25% in 2007) paid on the retirement age from 55 to 60;
Survivor benefit (lumpsum equal to total contributions plus investment revenues, including funeral grant of Nrp 5000 or € 48,80) paid at the time of death of the fund member;
Permanent disability benefit: a lumpsum of Nrp 55,000 or € 526 is paid;
Note that a) meanwhile and under qualifying conditions a loan can be provided out of the fund member’s own account to finance e.g. the costs of housing, education etc;
Note furthermore that b) government employees also receive an additional monthly pension (their survivors an additional payment for up to 7 years);
Administered by the Employees Provident Fund.

Social assistance: Eligible are Nepal citizens aged 75 or older, widows aged 60 or older and disabled people over 20 years of age;
Financing by the government;
Old-age allowance (250 Nrp or € 2.40 a month) paid to Nepalese citizens over 75 years of age;
Survivor allowance (150 Nrp or € 1.44 a month) paid to Nepalese widows over 60 years of age (means-tested);
Disability pension for persons over 20 years of age in case of blindness and having lost the use of feet or hands: Nrp 250 or € 2.39 monthly is paid;
Administered by the Ministry of Local Development.