



## *VPS – Challenges and Way Forward*

*Let the excitement begin – Happy Retirement*  
*Humaira Sardar Ali*

This is true for individuals who retire in welfare states having social security plan and a monthly retirement income. Countries where social security plans are not State's primary responsibility, the retirement planning becomes food for thought for individuals and private pension planning paves its way. Regrettably, Pakistan is one such State.

Considering the absence of a robust social security plan maintained by the State and curtailment of pension plans offered by employers, the private pension plan was introduced in 2005 under the Voluntary Pension System Rules, 2005 (VPS).

VPS is similar to the successful Chile Pension Model based on defined contribution fully funded individualized capital account except for VPS being the voluntary pension scheme. Chile Model was a success and was adopted mutatis mutandis across the globe. Due to the reforms in Chile's social security system, that state managed to reach 62% of pension fund assets to GDP ratio up to 2012, evidencing huge success.

Despite adopting a successful pension model and AUMs reaching up to 13 billion in 8 years at an average growth rate of 56.6% exhibiting a phenomenal growth given the financial and economic instability within the country, the VPS is still in its introduction phase. Features like flexible contribution, tax credits, asset allocation, choice of conventional and Shariah compliant investments, portability benefits on withdrawal after retirement, performance benchmarking and transparency in reporting return and performance are not offered by any other competing options like Provident Fund (PF), Gratuity Fund (GF) and Employee Old-Age Benefit Institution (EOBI).

On comparison drawn amongst Provident Fund (PF), Employee Old-Age Benefit Institution (EOBI), and Voluntary Pension Scheme the observations are:

- PF/GF/EOBI is restricted to employment whereas VPS is not
- Transparency in reporting and operating is available by VPS
- No choice of selecting investment allocation is available for OSS/EOBI but is available for VPS
- No transfer of investments allowed except for VPS
- No monthly payment on retirement except for EOBI and choice of annuity purchase /monthly income payment plan in VPS.
- Tax free withdrawals allowed only in PF prior to retirement
- Performance measurement / monitoring against benchmarking is available only in VPS
- Tax credits are available only in VPS, though applicable for every participant, effective only salaried class is taking benefit of it as self-employed are taxed under Presumptive tax regime.
- Tax free withdrawals are in PF only

The possible causes for growth limitations faced by VPS are:

1. The product features as compared to other retirement benefits
2. Perception of VPS being expensive amongst other retirement benefits
3. Product visibility and awareness of retirement planning

As Norman Vincent Peale said "Every problem contains the seed of its own solution". Accordingly, there are possible solutions which could help in diminution of the growth limitations. Taking into consideration that VPS being a pension plan spans over long term, the solutions vary from short term to long term. The amendments below are based on short term.



## PRODUCT:

Since it's a retirement plan for all, be it unemployed, employed and self-employed, the recommendation in product features is:

1. **Contribution:** Should be flexible and monthly, subject to tax credit, however unemployed and self-employed are the ones who are unable to avail any tax credits for no income and income taxed under presumptive tax regime respectively. For, unemployed-no recommendations are proposed however for self-employed, the tax credit available under section 63 which is nullified by section 169 of the Ordinance, could be given tax credit in the form of cash, investing on their behalf in the fund. This cash back tax credit facility is introduced in the form of bonus by UK Government to save GBP 4,000 per year for home purchase or retirement.
2. **Withdrawal / Pledge facility:** As available in other retirement plans across the world, withdrawals are allowed, however considering the contributing, savings and income replacement rate of Pakistan, withdrawals should be allowed for basic reasons like home purchase, self-education expenses under hardship restriction allowance. No withdrawal to be allowed however pledge or lien be allowed up to 50% of the accumulated balance.

## PLACE:

On December 18, 2013, a dedicated website was launched at URL [www.pensionfunds.com.pk](http://www.pensionfunds.com.pk) to promote VPS. The website should serve as HUB for all the VPS participants. Place for active members, online statement, registration, making contribution, employers making contributions, receiving income, withdrawal and all in all online account availability should be ensured irrespective of the pension fund manager. The concept is replication of teacher's pension website in UK [www.teacherspensions.co.uk](http://www.teacherspensions.co.uk). News letter and major amendments affecting contributors/participants should be delivered update them with the laws. The real time performance summary should also be available on the website.

## PRICE:

Since VPS has been held responsible for its expenses like management fee, annual fee and sales load etc. but mitigated by better returns as compared to other retirement schemes, there is an option of converting from active management of funds to passive management of funds under index funds. Research paper 'The Arithmetic of "All-In Investment" Expenses' published by John C. Bogle in Financial Analysts Journal, 2014 showed that funds invested under index funds have low cost and helped in earning extra wealth of 65% for retirement plan investors. The numbers for Pakistani market would be different however the result would be similar. To decrease the cost, this could be an option.

## PROMOTION:

Since inception of VPS, joint efforts by AMCs have been made in collaboration with Federation of Pakistan Chambers of Commerce and Industry (FPCCI), Overseas Investors Chamber of Commerce and Industry (OICCI) and Central Depository Company of Pakistan Limited (CDC) to develop the awareness of retirement planning with VPS. The very first effort was made by MUFAP in collaboration with FPCCI and CDC with a seminar 'Mutual funds and VPS – An efficient way to save' held on February 3, 2012. All the members, industrialists and businessmen were invited and emphasis was placed on planning post retirement life to avoid financial problems.

Another, public awareness seminar was conducted by MUFAP and OICCI on June 3, 2013. The presentation on need for retirement plan was followed by panel discussion and question and answer session. The panelists identified the need of moving from defined benefit plan to defined contribution plan and advantages of VPS over PF such as individualized asset allocation, portability, tax advantages and an in built insurance wrap.



A website was also launched at URL [www.pensionfunds.com.pk](http://www.pensionfunds.com.pk) on December 18, 2013 to promote VPS.

These marketing efforts were effective as evident from the increase in number of participants and tremendous growth, however considerable efforts are still required to make this product visible in the market.

As highlighted in Statistics published in MUFAP's Yearbook 2015, the major contributors of VPS in terms of number of investors are in age group 30-40 years, the graduate and post graduate schools, be it finance or any other discipline, will be a good source for the awareness, financial literacy and would have a trickledown effect in changing the mind set for retirement planning.

Sessions with large corporations should be arranged to increase awareness amongst working class or employed individuals.

A drip and burst marketing campaign would help out in awareness for the plan, considering that it's a retail product. The plan should begin with a compelling message of 'Retire from work not from life'.

**Overall Plan:** Compel people To RETIRE FROM WORK NOT FROM LIFE

**Stakeholders:** All PFMs and MUFAP

**Product/Service:** VPS – a simple tax financed retirement plan

**Target Market:** Employers, employees, post graduate students, self-employed people.

**Distribution / delivery channels:** AMCs, distributors, banks, pension website, employers, active contributors

**Marketing activities:** Advertising, publications, sponsorship, workshops, seminars, guest speaker sessions, internal marketing, active contributors.

The short term amendments would have an effect in the growth of the plan yet it is a band aid solution when it comes to retirement planning in Pakistan. As suggested by President Roosevelt that in order to provide for the country's retirement needs, social security would need to be supplemented by personal savings accounts. Being a consumption oriented society where gross domestic saving rate is 8.96%\* the lowest in the region amongst comparable countries like India, Srilanka and Bangladesh, the only effective long term solution is to make the plan mandatory and finance the voluntary savings through tax. While doing so, factors like target market, contribution rate, income replacement rate, asset allocation, withdrawal need reconsideration. A complete new system covering the structure and its management would then be needed to implement the change.

Taking into consideration the changes in demographics, social and cultural values and the absence of social security plan in Pakistan, the need for retirement planning is crucial and important. Apart from changes in product features, cost and return, distribution and promotion, most important is the awareness not restricted to VPS but to change the psyche of the individuals to become income savvy and financially considerate while planning for retirement.

Source: *1Economic Research – Federal Reserve Bank of St. Louis*

\* *World Bank data 2015*