II. IS THE NATIONAL PENSION SYSTEM A ONE-WAY STREET?

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ABSTRACT

A new constitutional showdown is brewing in a domain that is as much political as much social. National Pension System which was ushered in as an instrument of social and financial reform has become a cause for a standoff between Centre and States and which may sooner than later be resolved by judicial forums. This piece discusses the background because of which the Old Pension System was replaced by the New Pension System and issues such as who has the right over funds, is the PFRDA Act even applicable to States, and whether the stand of NPS Trust and PFRDA to not to return the contributory funds to States violates constitutional principles. These discussions are of utmost importance for a nation that will in a few years see a significant rise in the aging population and a stable social welfare system is a necessity rather than a choice.

I. INTRODUCTION

Recent state elections have brought to light a government scheme after twenty years of it coming into force for the first time – National Pension System. This year itself state governments of Rajasthan, Chhattisgarh, Jharkhand, and Punjab have rolled back the scheme while the recently elected Himachal Pradesh government has promised to take similar action. However,

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at the same time, the Finance Minister of India has categorically said that the contributions made by these state governments and their employees to the National Pension System cannot be remitted back to the states even if they roll back the scheme. Thus, setting up the ground for a legal showdown between the Union and the State governments. This article does not intend to dwell on the politics and merit of these decisions but to understand the jurisprudence of the National Pension System and if it is headed to the Supreme Court sooner or later.

II. HISTORY OF THE OLD PENSION SYSTEM

The pension system of India is a legacy of British colonial rule. The Royal Commission of Civil Establishments first introduced a pension for government officials in 1881. In the following years, the pension system kept evolving especially based on reports like the Islington Commission Report of 1915, Montague-Chelmsford Report, and Lee Commission Report of 1924[1] and through the Government of India Act, 1919 and Government of India Act, 1935. Over the years pension was not only provided to Union and State Government employees but also to the employees of public sector undertakings.

Post-independence when India saw rapid increase and expansion of public sector undertakings, government jobs became one of the most sought-after employment opportunities for Indians. One of the main reasons for this was an assured pension to the employee as well as to their spouse and dependents. The pension amount during the period was determined based on

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[1] East India (Civil Services in India), *Report of the Royal Commission on the Superior Civil Services in India* (27 March 1924) <https://www.upsc.gov.in/sites/default/files/Sl-019-RprtRoyalCmsnSuperiorCivilSerIndiaLeeComsnRprt-1924_0.pdf> accessed 15 February 2023.

the last-drawn salary of the employee. Further, employees were not required to make any contribution towards the pension corpus and the responsibility or the creation of the pension corpus and payment of the same lied solely on the employer or the government. These pension systems were called Defined Benefit Schemes (or commonly known as Old Pension Systems) as only the benefit to the employee was defined and even the same was indexed, that is, the benefit amount would revise with the change in inflation rate. However, by the late 1990s, it has become apparent that this Defined Benefit Scheme was fiscally unsustainable and a reform in the pension system of India had become inevitable.

III. PROJECT OASIS AND BHATTACHARYA COMMITTEE REPORT

In 1998, the Union Ministry of Social Justice and Empowerment appointed a committee under the Chairmanship of Dr. S.A. Dave, former SEBI and UTI Chairman. The Committee submitted its report on January 11, 2000, to the ministry titled 'Project OASIS (Old Age Social and Income Security) Report'.[2]The Report flagged the fiscally unsustainable old pension system ("**OPS**") and proposed a New Pension System (it has been rechristened as the National Pension System) which it defined as 'a pension system which can be used by individuals spread all over India, which enables them to attain old age security at the price of modest contribution rates through their working career. It is simple and convenient to use and has the capability for converting modest contributions into reasonably large and comfortable sums in an almost risk-

[2] Pension Fund Regulatory & Development Authority, *The Project OASIS Report* (11 January 2000) <https://www.pfrda.org.in/writereaddata/links/rep2d5d02004-a7c9-4875-be6e-f8b92744e210.pdf> accessed 15 February 2023.

free manner for old-age security.' Thus, the path towards Defined Contribution System for pension was laid down with this report.

This report was soon followed by an October 2003 Reserve Bank of India report titled 'Report of the Group to Study the Pension Liabilities of the State Governments' submitted by a committee headed by Mr. B.K. Bhattacharya.[3] The Report raised concern over the rapid increase in pension payments as compared to states' revenue receipts. The Report noted that a structural change in the pension system is not only required but the present system is also unsustainable. Thus, the report recommended that there is a need for a Defined Contribution scheme with contributions from both, the employee and the employer. The report also suggested that State Governments may adopt a hybrid of the Defined Contribution – Defined Benefit System which will be a contributory system with a guarantee of an appropriate level of pension fixed by individual state governments. However, what was clear was that a purely Defined Benefit scheme was no longer an option.

In essence, the two reports not only raised issues about the fiscally unsustainable OPS but made recommendations about the structure, investment policies, roles of various intermediaries, etc. which finally culminated in the National Pension System.

IV. INTRODUCTION OF THE NATIONAL PENSION SYSTEM

The Union Government introduced the New Pension System (as it was named then) through a notification on December 22, 2003, as a 'new

[3] Reserve Bank of India, *Report of the Group to Study the Pension Liabilities of the State Governments* (14 October 2003) <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/51177.pdf> accessed 15 February 2023.

restructured defined contribution pension system'. The notification further provided that the 'system would be mandatory for all new recruits to the Central Government service from 1st of January 2004 (except the armed forces in the first stage)'.[4] In the following years, this National Pension System was extended to autonomous bodies, public sector undertakings, state governments, municipal bodies, and even individuals. In 2018, Tripura became one of the last states to adopt the National Pension System, with the only exception of Tamil Nadu (which has its own contributory pension system) and West Bengal. Today almost 1.5 crore citizens have subscribed to the National Pension System.

The Parliament in 2013 passed the Pension Fund Regulatory and Development Authority Act, 2013 ("**PFRDA Act**") which was the culmination of all the notifications issued since 2003 with respect to the National Pension System and also the formalization of the Pension Fund Regulatory and Development Authority, the regulator of the National Pension System. The structure of this new system is based on the recommendations of the OASIS Committee Report where it is the individuals who are at the center of the pension system. Thus, the concept of an individual pension account has been introduced in the PFRDA Act and has been defined as "an account of a subscriber, executed by a contract setting out the terms and conditions under the National Pension System."[5]

The definition is particularly important as under the new system it is the individuals who have the ultimate say on their funds, the fund managers who shall manage it, its deployment, and even its withdrawal. As the system

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[4] Ministry of Finance, *New Pension Scheme* (Notification Reference No. F. No. 5/7/2003-ECB&PR, 22 December 2003).
[5] Pension Fund Regulatory and Development Authority Act, 2013 (Act 23 of 2013) (PFRDA Act 2013), s 2(1)(e).

has evolved over the years, the subscribers (account holders who are identified as subscribers under the PFRDA Act)[6] can decide and modify every aspect of their account other than the contribution amount of their employers.

The right of the subscribers to make decisions about their pension extends to the right to decide the quantum of accumulated pension wealth[7] that shall be used by the subscribers to purchase the annuity and the type of the annuity which shall be purchased.[8]

However, clamors of the inadequacy of the pension amount soon started being raised by the subscribers. While the National Pension System reduced the fiscal burden on the government significantly, employees more often than not were left with pension amount which was lower than those provided in the Old Pension System. The mean expected level of an annuity can range from 34% to 42% of the last drawn salary.[9] It should further be noted that even the same reduces over time as the annuity amount remains constant, irrespective of change in inflation, whereas, under the OPS, the pension amount kept getting revised to factor in the inflation. Keeping the electoral politics aside, it was this inadequacy of pension amount which led to the demand for restoration of OPS in the first place and which as already mentioned, might lead to a constitutional standoff between the Centre and the States.

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[6] ibid s 2(1)(t).

[7] Pension Fund Regulatory and Development Authority (Exits and Withdrawals Under the National Pension System) Regulations, 2015, No. PFRDA/12/RGL/139/8– (PFRDA Regulations, 2015), reg 2(1)(b).

[8] ibid reg 3 & reg 4.

[9] T.S. Vaidyanathan, 'Pension System: The old versus the new' *The Hindu Business Line* (1 June 2022) <https://www.thehindubusinessline.com/opinion/pension-system-the-old-versus-the-new/article65476009.ece> accessed 15 February 2023.

V. WHOSE MONEY IS IT ANYWAY?

As has been discussed above, the pension accounts of the subscribers have been formed pursuant to the contract signed between them. Finance Minister in her recent comments has relied upon this very factor to say that states cannot legally seek the money deposited by them in the account of their employees even if they reinstate the OPS. But is it really true that the state governments have no say on the funds contributed by them to their employees' accounts even if they are providing their employees an alternate option?

PFRDA (Exit and Withdrawals under the NPS) Regulations, 2015 provides family members of a deceased subscriber or a subscriber who has been invalidated or disabled during service an option to avail the additional pensionary benefits other than the National Pension System if provided by the Government or the employer.[10] However, in case such a subscriber or family members of the deceased subscriber avails such an option, the Government or the employer can adjust or seek transfer of part or full accumulated pension corpus of the subscriber to itself if the service rules provide so.

Even the Central Government through the Central Civil Services (Implementation of NPS) Rules, 2021 provides that in case the family of a subscriber is provided benefits under the Central Civil Services (Extraordinary Pension) Rules, 1939 or Central Civil Services (Pension) Rules, 1972 then the contribution of the Central Government and returns thereof in the accumulated pension wealth shall be transferred to the Central Government.[11]

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[10] PFRDA Regulations 2015, reg 6(e).

[11] The Central Civil Services (Implementation of National Pension System) Rules, 2021, G.S.R 227 (E), rule 20(2).

Thus, not only the regulations of PFRDA but even the rules made by the Central Government itself provide an option to the employer to at least receive a part, if not the whole, of the corpus, contributed to the individual pension account of their employee.

However, it is not only these regulations and rules which allow employers to shift their employees out of the National Pension System to another scheme and receive corpus from the individual pension account of their employees. There are other instances as well.

A. Modification of December 22, 2003 notification by Court Orders

In the matter of *Parmanand Yadav v. Union of India,*[12] the petitioners filed a writ petition challenging their inclusion in the National Pension System contending that they had qualified for the exams prior to notification of the National Pension System on December 22, 2003, and it was only due to delay at the end of the Central Government that their appointment letter was issued after the notification. The writ was allowed by the High Court instructing the Central Government to provide benefits of the Old Pension System to the petitioners. Thus, the order effectively modified the December 22, 2003 notification which had provided that the National Pension System would be mandatory for all new recruits to the Central Government service from the 1st of January 2004. A similar order was issued by the Delhi High Court in *Tanaka Ram v. Union of India*,[13] and a Special Leave Petition[14] and a Review Petition[15] of the Central Government before the Supreme Court of India against the order have been dismissed. In fact, the Hon'ble Delhi High Court

[12] *Parmanand Yadav v. Union of India*, WP(C) 3834/2013.
[13] *Tanaka Ram v. Union of India*, 2019 SCC Online Del 6962.
[14] SLP (CC) Diary No 25228/2019.
[15] Review Petition No 2188/2020.

in *Shyam Kumar Choudhary v. Union of India*[16] opined that the benefit of the Old Pension System should be extended to all similarly placed employees.

The notification was further modified by the *Bharat Singh v. Union of India*[17] where the Hon'ble Delhi High Court held that the benefit of the Old Pension System should be extended to employees whose recruitment process had been initiated prior to December 31, 2003.

Thus, these orders effectively modified December 22, 2003 notification to provide that the National Pension System shall be applicable to the recruitment process which was initiated on or after January 01, 2004.

Consequently, to give effect to these orders of the Supreme Court and the High Courts, various ministries of the Central Government through circulars and office memorandums provided an option to their employees to exercise one time option to opt out of the National Pension System and enroll in Old Pension System.[18] These circulars and memorandums also provided that the contribution of the Central Government to the individual pension account of the subscribers shall be remitted to the Central Government while employees' contributions shall be credited to their individual General Provident Fund account.

Thus, the question that might need to be judicially determined with respect to the State's decision to provide benefits of the Old Pension System is how the same is different from the Court's own decision to allow benefits of the Old Pension System by modifying the original notification. Further, if

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[16] *Shyam Kumar Choudhary v. Union of India*, 2019 SCC Online Del 11891.
[17] *Bharat Singh v. Union of India*, 2021 SCC Online Del 5283.
[18] Department of Pension & PW, *Office Memorandum - Coverage under Central Civil Services (Pension) Rules, 1972* (O.M. No. 57/04/2019-P&PW(B), 17 February 2020) < https://documents.doptcirculars.nic.in/D3/D03ppw/54_04_2019_P_PW_B3hUVY.PDF> accessed 15 February 2023.

the Central Government can remit the contributions made by it while providing benefits of the Old Pension System why can't States do the same?

B. PFRDA Act and Government Sector Subscribers

PFRDA Act provided that the New Pension System shall be applicable to all the employees of the Central Government who were appointed on or after January 01, 2004.[19] The Act also clarified that the new pension system introduced in 2003 shall be deemed to be National Pension System.[20] The Act further provided that any State Government or administrator of a Union territory may, by notification, extend the National Pension System to its employees.[21] A question arises as to this aspect, whether the states are needed to issue notification again to extend the application of the National Pension System or whether the notification already issued by states prior to the enactment of the PFRDA Act is sufficient.

In this regard, it is particularly noteworthy that the 'Savings' section of the PFRDA Act provided that anything done or action taken by the Interim PFRDA or the Central Government shall be deemed to have been done or taken under the corresponding provisions of the PFRDA Act.[22] Thus, the prior notification of the Central Government and various ministries under it to extend NPS to its employees was saved by this section.

However, the 'Savings' section of the PFRDA Act does not save the prior notifications made by the State Governments and Union Territories. The

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[19] PFRDA Act 2013, s 12(3)(d).
[20] PFRDA Act 2013, s 20(1).
[21] PFRDA Act 2013, s 12(4).
[22] PFRDA Act 2013, s 56.

question, therefore is whether the notifications made by the State Governments prior to the enactment of this Act are valid or not.

Courts have in various instances held that in case a savings clause does not have specific saving actions initiated under previous legislation the same shall not be allowed to be continued.[23] However, a distinction from this principle was drawn by the Supreme Court in the matter of *Fibre Boards Pvt. Ltd. v. Commissioner of Income Tax, Bangalore*[24] where it was held that when a notification was brought in under a previous provision and the new enactment repeals the previous law but has a similar provision, then the notification shall be considered to be notified under the new law.

In the case of the National Pension System, the notification by State Governments was not under any Act, however, they were notified by the State based on their inherent power to determine service conditions of their employees. While it may be argued that based on the Supreme Court's interpretation these notifications should be considered to be notified under PFRDA Act itself. However, it is notable that several states like Goa,[25] Karnataka[26] , and Himachal Pradesh[27] have brought another notification after the enactment of the PFRDA Act to specifically provide that the extension of the National Pension System to their employees under relevant provisions of the PFRDA Act. Thus, it can be understood that at least several states are of

[23] *Kolhapur Canesugar Works Ltd. v. Union of India*, (2000) 2 SCC 536.
[24] *Fibre Boards Pvt. Ltd. v. Commissioner of Income Tax, Bangalore*, (2015) 10 SCC 333.
[25] Department of Finance, Government of Goa (Notification No 12/4/2004-Fin(R&C)/Part-I, 19 September 2019) <https://goaprintingpress.gov.in/downloads/2122/2122-21-SI-OG-0.pdf> accessed 15 February 2023.
[26] Department of Finance, Government of Karnataka, *Changing the name of New Defined Contributory Pension Scheme to National Pension Scheme – reg.* (Notification No FD/113/PEN/2021 dated August 10, 2021).
[27] Finance (Pension) Department, Government of Himachal Pradesh (Notification No Fin (Pem) A (3)-1/2009, 24 September 2019).

the opinion that the notifications prior to the enactment PFRDA Act have not been saved.

Therefore, another question that may arise is whether the notification of some of these states with respect to the National Pension System, which has decided to restore the Old Pension System, are even legally valid.

VI. RIGHT OF STATE TO EXIT A CONTRACT

Under the present NPS Architecture, a State Government enters into an agreement with the NPS Trust. What is peculiar about this agreement is that the State Governments cannot modify or alter the terms of the agreement signed with NPS Trust without prior approval of the regulator, PFRDA.

It has also been reported that in case of any difference or dispute, the same shall be referred to PFRDA, who in turn shall appoint a sole arbitrator for the determination of the difference or dispute, and the determination of the sole arbitrator shall be final and binding.

The Supreme Court of India in the matter of *Perkins Eastman Architect DPC v. HSS (India) Ltd.*[28] has held that a party that has an interest in the outcome of the dispute should not have the sole right to appoint an arbitrator. The principle laid down by the Supreme Court is important to ensure the independence of the judicial process.

In the present instance, where States and NPS Trust have entered into an agreement it can be argued that the appointment of sole arbitrator is being done by PFRDA and thus, the principle laid down by the Supreme Court is not violated. However, a deeper look into the matter might show a totally different

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[28] *Perkins Eastman Architect DPC v. HSS (India) Ltd.*, (2020) 20 SCC 760.

picture. PFRDA, unlike other regulators, undertakes the dual role of both, regulator of the National Pension System as well as settlor of NPS Trust. While in its role as regulator, it is supposed to be a neutral guardian of the system, it also appoints the trustees of the NPS Trust and it is under PFRDA's overall supervision that the NPS Trust works. Further, even the Chief Executive Officer of NPS Trust is appointed by PFRDA. Thus, the question that arises is whether in case the matter goes to arbitration can PFRDA really be considered independent from NPS Trust and be allowed to appoint the sole arbitrator.

Even otherwise there is the question is whether a State Government is bound by the agreement and cannot terminate the contract. It is an established principle of law that even a perpetual contract may be terminated and the party terminating the contract may be liable to pay damages to the other party. However, it cannot be anyone's case that a State Government once it has entered into an agreement cannot terminate the same by virtue of a change in its policy.

Additionally, pension by the State Government falls under Entry 42, List II, Schedule VII of the Constitution of India and thus, it falls under the exclusive domain of the State Government. Thus, any argument that the State Government cannot terminate the contract with the NPS Trust after entering into one will go against the constitutional ethos.

Therefore, Courts might have to determine the very nature of the relationship between the State Governments, NPS Trust, and PFRDA.

VII. CONCLUSION

The Centre and State relationship cannot be analyzed by being oblivious to the political relationship between them. However, it is also important that the merits of different arguments are not lost in politics. Rather than being at loggerheads States and Centre should consider other options suggested by OASIS and Bhattacharya Committee Reports or maybe find an even better solution. India's transition towards a developed economy will not be complete until we can create a robust social security architecture.