ISSN PRINT 2319 1775 Online 2320 7876
Research paper **Volume 11, Iss 12, 2022**

A Comparative Analysis of the Return on Investment in National Pension System (NPS) and Hybrid Mutual Funds

Mr. Chetan Prabhakar Khandekar
(Ph.D. Research Scholar)
University of Mumbai's Ph.D. Research Center in Accountancy at R.E. Society's R.P.Gogate College of Arts & Science and R.V.Jogalekar College of Commerce Ratnagiri 415612 (Maharashtra)

Dr. Makarand Raghunath Sakhalkar
(Ph.D. Research Guide)
University of Mumbai's Ph.D. Research Center in Accountancy at R.E. Society's R.P.Gogate College of Arts & Science and R.V.Jogalekar College of Commerce Ratnagiri 415612 (Maharashtra)

Abstract:

New Pension Scheme is launched in 2004 to provide a retirement financial safety to employees. Afterwards it has been expanded from government employees to private sector employees. Currently it is available to any person who aims at invest in this scheme voluntarily. Mutual fund has been considered as a most flexible and versatile investment alternative across all categories of investors.

It is a common perception that NPS provides below average returns and is not beneficial for the employees if they aim at generating sufficient retirement corpus on their superannuation. This article aims at comparing the returns provided by NPS with that of mutual fund.

Keywords: New Pension Scheme, mutual funds, retirement planning, hybrid fund, equity savings, tax benefits

1. Introduction:

A. New/ National Pension Scheme :

The New Pension Scheme (NPS), which has been renamed the National Pension System (NPS), is a government-sponsored pension scheme in India. It was introduced in 2004 and is regulated and administered by the Pension Fund Regulatory and Development Authority (PFRDA). The NPS is designed to help individuals, both employed and self-employed, save for their retirement and create a financial safety net for their post-retirement years.

Key features and aspects of the National Pension System (NPS) include:

a. **Tier Structure:** NPS operates in two tiers:

- Tier I: This is the mandatory, long-term retirement savings account. Contributions to this account are locked in until retirement, and partial withdrawals are allowed under specific circumstances.
- Tier II: This is a voluntary savings account that offers more flexibility for withdrawals and is primarily used for short-term financial goals.

b. **Contributions:**

- Subscribers can make regular contributions to their Tier I NPS account. These contributions are invested in various asset classes, including equities, corporate bonds, and government securities.
- Tier I contributions are eligible for a tax deduction under Section 80CCD of the Income Tax Act in India, subject to specified limits.

c. **Investment Choices:**

- NPS offers two investment options: Active Choice and Auto Choice.
    - Active Choice allows subscribers to decide the asset allocation among the available asset classes.
    - Auto Choice invests the funds based on the subscriber's age, automatically reducing exposure to riskier assets as they approach retirement.

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d. **Regulated Investment Structure:**

- NPS investments are managed by Pension Fund Managers (PFMs) selected by the subscribers. Subscribers can choose from multiple PFMs and can switch between them if needed.

e. **Exit and Annuity:**

- At retirement, subscribers can withdraw a portion of the accumulated corpus as a lump sum (subject to specified conditions) and use the remaining amount to purchase an annuity that provides a regular pension income.
- NPS aims to ensure a steady income stream for retirees through annuitization.

f. **Portability:**

- NPS is a portable scheme, which means subscribers can continue their accounts even if they change employers or locations. The account remains the same, and they can keep contributing.

g. **Mandatory Annuity Purchase:**

- At least 40% of the accumulated corpus must be used to purchase an annuity. This ensures that subscribers have a source of regular income during retirement.

h. **Early Withdrawals:**

- Partial withdrawals are allowed for specific purposes such as higher education, buying a house, and medical emergencies. However, these withdrawals are subject to conditions and limits.

i. **Tax Benefits:**

- Contributions to the NPS Tier I account are eligible for tax deductions under Section 80CCD (1B) in addition to the Section 80C limit. The maturity amount, including the lump sum withdrawal, is partially taxable.

j. **Swavalamban Scheme:**

- The government has launched the Swavalamban Scheme under NPS to encourage individuals from the unorganized sector to save for their retirement. It offers government contributions for eligible subscribers.

The NPS is a versatile retirement savings scheme which provides individuals with a structured and regulated way to save for their retirement. It offers flexibility in investment choices and portability, making it suitable for various types of investors. To participate in NPS, individuals need to open an account through a Point of Presence (POP) or enroll through their employers, if applicable.

Return on Investment in NPS

The return on investment (ROI) in the New Pension Scheme (NPS), now known as the National Pension System, is not fixed or guaranteed like a traditional savings instrument such as a fixed deposit. The NPS is a market-linked investment scheme where the returns are determined by the performance of the underlying investments made by the subscriber in various asset classes like equities, corporate bonds, and government securities.

Returns in NPS are based on following factors:

1. **Asset Allocation:** NPS allows subscribers to choose their asset allocation within the defined limits. They can decide how much of their contributions should be invested in equity (E), corporate debt (C), and government securities (G). This choice has a significant impact on the potential returns and risk associated with the investment.
2. **Market Performance:** The returns on NPS investments are directly influenced by the performance of the underlying asset classes in the financial markets. For instance, if the equity market performs well, the equity portion of the NPS portfolio may generate higher returns.
3. **Fund Manager's Performance:** The Pension Fund Managers (PFMs) appointed by the NPS subscribers play a crucial role in managing the investments and generating returns. Different PFMs have different strategies and track records, which can impact the returns on the investment.
4. **Account Type:** NPS operates in two tiers: Tier I and Tier II. Tier I is the long-term retirement savings account, while Tier II is a voluntary savings account. The returns on Tier I are typically influenced by long-term market dynamics, while Tier II offers more flexibility and may generate shorter-term returns.

5. **Fees and Charges:** NPS charges certain fees for managing the account, which can affect the net returns. These fees include fund management charges, custodian charges, and account opening and maintenance charges.

It's important to note that NPS is designed for long-term retirement planning. The returns can vary from year to year and are subject to market volatility. Additionally, while NPS does not guarantee fixed returns, it offers advantages like low costs, tax benefits, and a structured approach to retirement planning.

B. Mutual Fund :

Mutual funds offer a variety of investment options to cater to different financial goals, risk profiles, and investment preferences. Here are some common types of mutual fund schemes based on their investment objectives and asset classes:

1. **Equity Mutual Funds:**
    - These funds primarily invest in stocks or equities of companies. They are suitable for investors looking for the potential for long-term capital appreciation. Equity funds can further be categorized based on market capitalization (large-cap, mid-cap, small-cap), sector (technology, healthcare, etc.), or investment style (value, growth, dividend-oriented).
2. **Debt Mutual Funds:**
    - Debt funds invest in fixed-income securities like bonds, government securities, corporate debt, and money market instruments. They are ideal for conservative investors seeking regular income and lower risk compared to equity funds.
3. **Hybrid Mutual Funds:**
    - Also known as balanced funds, hybrid funds invest in a mix of both equity and debt instruments. They aim to provide a balanced approach to risk and return, making them suitable for investors seeking both income and capital appreciation.

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4. **Money Market Mutual Funds:**
    - Money market funds primarily invest in short-term debt instruments like Treasury bills, certificates of deposit, and commercial paper. They are a low-risk option and provide liquidity but may offer lower returns compared to other types of funds.
5. **Index Mutual Funds:**
    - These funds aim to replicate the performance of a specific stock market index, such as the S&P 500 or Nifty 50. They offer a cost-effective way to gain exposure to a broad market without active management.
6. **Sectoral and Thematic Mutual Funds:**
    - Sectoral funds focus on a specific sector, such as technology, healthcare, or financial services. Thematic funds invest in themes or trends like ESG (environmental, social, and governance) or infrastructure. These funds can provide concentrated exposure but come with higher sector-specific risk.
7. **Tax-Saving (ELSS) Mutual Funds:**
    - Equity Linked Savings Schemes (ELSS) are a type of equity mutual fund with a lock-in period of three years. They offer tax benefits under Section 80C of the Income Tax Act in India, making them a popular choice for tax planning.
8. **Liquid and Ultra-Short-Term Mutual Funds:**
    - These funds invest in very short-term debt instruments and offer high liquidity. They are suitable for parking idle funds for the short term or for meeting emergency cash requirements.
9. **Arbitrage Mutual Funds:**
    - Arbitrage funds aim to take advantage of price differentials between the cash and futures markets. They are relatively low-risk and tax-efficient in certain situations.
10. **Gilt Mutual Funds:**
    - Gilt funds invest in government securities and bonds, offering a higher level of safety compared to other debt funds. They can be ideal for risk-averse investors.

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11. **International Mutual Funds:**
    - These funds invest in foreign assets, including stocks and bonds of international companies and governments. They provide diversification by accessing global markets and currency exposure.
12. **Gold Mutual Funds:**
    - Gold funds or gold ETFs invest in physical gold or gold-related assets, allowing investors to gain exposure to the price of gold without owning the physical metal.
13. **Fund of Funds (FoF):**
    - FoFs invest in other mutual funds instead of individual securities. They provide a way to achieve diversification across various asset classes and fund managers within a single fund.

Each type of mutual fund scheme comes with its own set of risks and potential rewards. It's essential for investors to assess their financial goals, risk tolerance, and investment horizon before selecting the most suitable mutual fund schemes for their portfolio. However mutual fund is rightly considered as a flexible and versatile investment alternative which is suitable for all types of investors.

2. Comparison of Returns on Investment in Mutual fund and NPS

New Pension scheme Fund managers have certain restrictions for their operations. They have limited scope for diversification like mutual fund. So in NPS, the fund managers have to focus more on safety as well as higher returns. There is restriction on direct equity investment of funds collected from NPS subscribers. So we can compare NPS with similar category of mutual fund scheme i.e. hybrid scheme.

Hybrid scheme has several categories like debt oriented, equity oriented, dynamic asset allocation, equity savings etc. Here we have considered only selected hybrid schemes for comparison which are similar to that of NPS funds.

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Schemes considered for comparison are

Mutual fund

a. Dynamic asset allocation plans

b. Equity saving plans

c. Hybrid Debt oriented plans**.**

New Pension Scheme

Schemes applicable for Central and State Government Employees

a. Central Government Plans LIC Pension Fund

b. Central Government Plans SBI Pension Fund

c. Central Government Plans UTI Retirement Solutions

d. State Government Plans LIC Pension Fund

e. State Government Plans SBI Pension Fund

f. State Government Plans UTI Retirement Solutions

IJFANS INTERNATIONAL JOURNAL OF FOOD AND NUTRITIONAL SCIENCES
ISSN PRINT 2319 1775 Online 2320 7876
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10 Year Returns of Selected Mutual fund Schemes

Funds	3 Yr Ret (%)	5 Yr Ret (%)	10 Yr Ret (%)
SBI Magnum Children's Benefit Fund - Savings Plan	14.09	9.94	12.91
UTI Children's Career Fund-Savings Plan	11.20	8.26	10.25
ICICI Prudential Regular Savings Fund	8.99	9.11	10.18
Aditya Birla Sun Life Regular Savings Fund	10.93	8.28	9.87
Kotak Debt Hybrid Fund	10.70	10.49	9.87
HDFC Hybrid Debt Fund	11.69	9.45	9.85
UTI Retirement Fund	13.98	9.09	9.84
Franklin India Pension Fund	8.97	8.07	9.70
SBI Conservative Hybrid Fund	11.40	10.28	9.56
HDFC Equity Savings Fund	13.47	9.13	9.52
ICICI Prudential Income Optimizer Fund (FOF)	11.07	9.49	9.20
Bandhan Asset Allocation Fund - Moderate Plan	10.16	8.25	9.01
UTI Conservative Hybrid Fund	10.13	7.62	9.00
Tata Retirement Savings Fund - Conservative Plan	6.57	7.38	8.71
HSBC Equity Savings Fund	12.51	8.86	8.70
Canara Robeco Conservative Hybrid Fund	7.66	9.00	8.65
Bank of India Conservative Hybrid Fund - Eco Plan	13.45	8.23	8.39
Franklin India Debt Hybrid Fund	7.73	7.30	8.28
Sundaram Debt Oriented Hybrid Fund	8.57	6.42	8.28
PGIM India Equity Savings Fund	9.25	7.42	8.23
Bank of India Conservative Hybrid Fund	13.27	7.99	8.19
Bandhan Asset Allocation Fund - Conservative Plan	6.66	6.87	7.98
Sundaram Equity Savings Fund	10.71	8.41	7.91
HSBC Conservative Hybrid Fund	6.97	7.35	7.80
Axis Regular Saver Fund	7.11	6.70	7.74
Baroda BNP Paribas Conservative Hybrid Fund	6.65	6.98	7.71
Bandhan Regular Savings Fund	5.12	6.03	7.47
DSP Regular Savings Fund	7.66	6.88	7.39
Tata Equity Savings Fund	8.98	7.93	7.20
LIC MF Equity Savings Fund	9.20	7.56	6.73
Nippon India Hybrid Bond Fund	8.59	3.51	6.72
Bandhan Equity Savings Fund	8.10	6.94	6.50
LIC MF Conservative Hybrid Fund	5.33	6.51	6.48
Navi Regular Savings Fund	5.69	5.46	6.44
AVERAGE	***9.49***	***7.86***	***8.54***

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10 Year Returns of Selected NPS Funds

Tier & Plan	3 Yr Ret (%)	5 Yr Ret (%)	10 Yr Ret (%)
Central Government Plans LIC Pension Fund	7.03	9.05	9.47
Central Government Plans SBI Pension Fund	6.60	9.04	9.51
Central Government Plans UTI Retirement Solutions	6.78	8.99	9.46
State Government Plans LIC Pension Fund	6.92	8.99	9.45
State Government Plans SBI Pension Fund	6.46	9.00	9.53
State Government Plans UTI Retirement Solutions	6.76	8.98	9.45
AVERAGE	**6.76**	**9.01**	**9.48**

C. Findings

a. 3 year average returns of Mutual fund schemes are much higher as compared to NPS.

b. 5 Year average returns of NPS are higher than Mutual fund schemes

c. 10 Year average returns of NPS are slightly higher than Mutual fund schemes.

d. Few Mutual fund schemes have generated much higher returns than NPS in short term as well as long term.

D. Conclusion

1. From the table it is clear that if we compare NPS with same category of mutual fund scheme, the returns in long term can beat the mutual fund. Basically NPS is designed for long term investment horizon. Similarly it is designed for safety of funds by investing maximum proportion in debt instruments or government securities. So it serves the purpose for which it is designed for.
2. If we compare tax benefits available for NPS contribution of subscriber, it can be more attractive to invest in NPS due to effective post tax returns.
3. In case of premature withdrawal facility, mutual funds are always favorite due to simple withdrawal procedure. So returns generated by NPS are only for comparison purpose. At the time of actual withdrawal, there can be variation of either side.

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E. Recommendations

a. NPS Tier 1 subscribers are always government employees. They have to contribute certain amount in NPS on monthly basis. So they can consider this contribution as fixed income component in their portfolio.

b. NPS Tier 1 subscribers can invest their surplus funds in pure equity mutual fund schemes in order to generate higher returns by taking certain amount of higher risk.

c. NPS Tier 1 subscribers can also think of investment directly into stock market by getting proper knowledge or advice from their personal financial planner.

F. Limitations

a. This article covers only selected mutual fund schemes due to nature of NPS structure.

b. NPS Tier II scheme is not compared with mutual fund.

c. NPS Tier I scheme for public sector undertakings is not considered for comparison with selected mutual funds.

d. Tax benefits available to NPS subscribers can be additionally considered in order to calculate effective returns.

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