

REVIEW ARTICLE

## Understanding the role of financial literacy in pension planning: Overview of national pension scheme

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**Abstract:** Financial security after retirement is a growing concern, especially in economies where Social Security schemes and systems are limited and not well-structured. The National Pension Scheme (NPS) serves as a structured retirement savings option, depending on the individual's financial literacy level. The need to understand financial concepts such as savings, investment, and the amount of annuity to be paid adds to the process of empowering individuals to make informed pension planning decisions. This examines the factors influencing pension-related decisions and barriers to financial awareness and provides strategies that could improve overall literacy. This is a descriptive study, based on secondary data, which discusses the role of financial literacy in pension planning with a specific focus on the NPS. The study examines conceptual and policy-based insights related to financial literacy and retirement preparedness. However, challenges such as lack of awareness, certain misconceptions, and financial preferences continue to hinder this participation in various pension schemes. The findings explain that individuals with adequate financial knowledge are more likely to understand pension options like the NPS and the benefits they offer, while limited awareness and behavioural biases continue to hinder participation (Ricci & Caratelli, 2017). The significance of the study lies in highlighting the need to bridge the gap between financial knowledge and pension adoption, especially among informal sector workers and the self-employed. The study advocates for financial education and awareness programs to improve pension inclusion and long-term financial security. This study aims to contribute to the policy discussion and to enhance public awareness which altogether contributes to the efforts to enhance retirement planning in India.

**Keywords:** National pension scheme, Financial literacy, Awareness, Social security schemes

### Introduction

Retirement planning in today's world is very essential for ensuring that financial security stays in the later years, with increasing life expectancy today, all individuals are in need to make an informed decision about their level of financial stability. This study focuses specifically on the National Pension Scheme (NPS) due to its wide applicability, voluntary nature, and growing relevance as a government-backed retirement option for all Indian citizens, including self-employed and informal sector workers. Unlike traditional pension schemes, NPS offers flexibility, portability, market-linked returns, and tax benefits, making it a suitable model for examining the impact of financial literacy on pension behaviour. NPS is a government-backed pension scheme in India, which is structured and designed to provide a well-tailored retirement savings plan. However, many individuals lack awareness and understanding this pension plan is mandatory today.

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Financial literacy plays a key role in ensuring that effective participation has to be taken on those retirement schemes. This financial literacy includes the knowledge of saving, investment, and the tax benefits that can be enjoyed with the associated pension plan. Despite the availability of NPS, individuals and the informal sector remain unaware of the benefits that can be availed. The lack of understanding of the financial products and the benefits of the pension plan leads to poor retirement planning (Misra & Tankha, 2018). The paper explains the role of financial literacy and its relation to NPS adoption all over India. It also discusses the challenges that are faced, and the factors that influence it and also provides some strategies that could help in enhancing the awareness of pension schemes among the public.

### **Concept of Financial Literacy and its Relevance to Pension Planning**

Financial literacy commonly refers to an individual's ability to understand and process effectively. It includes knowledge about the savings, investment, and budgeting process, which has to be made in the beginning, and the benefits of the financial product are focused such as pension schemes (Atkinson & Messy, 2012). Financial literacy is not only focused on the education level of the individual but also the level of literacy or the knowledge they possess upon that subjective plan or the level of informed decision about income management and the future development of that financial security (Lusardi & Mitchell, 2011). Pension planning is a crucial aspect of financial literacy because it ensures that the staple income is being received after retirement. The post-retirement benefit that is enjoyed without adequate financial knowledge of the NPS, individuals may fail to save enough for their retirement and the investment would go to a poor state, many individuals delay or fail to take pension plans because of the misconception they take from the public or from any other peer to whom they ask for assistance because of the lack of awareness that individuals possess (Klapper et al., 2013). Lack of financial awareness results in poor pension participation. This is evident in cases where individuals are unable to comprehend the long-term implications of not saving adequately for retirement (Fornero & Monticone, 2011) observed that in Italy, limited financial literacy significantly reduced individuals' likelihood to participate in pension schemes, emphasising that awareness plays a vital role in informed retirement decision-making (Demirguc-Kunt et al., 2018). Financial literacy includes learning and understanding all the processes of the National pension scheme which will help the individual in planning a significantly compounding and long-term investment that they can carry for their post-retirement from the earning stage (Agarwal et al., 2007). It also enables them to evaluate the different pension schemes that are available in the current scenario and select the one which would benefit their need and strengthening the financial literacy level has to be done to have a comfortable post-retirement life (Bhushan & Medury, 2014).

### **Overview of National Pension Scheme**

NPS is a voluntary, well-structured, long-term retirement savings plan, which is launched by the government of India in 2004. This was initially designed for government employees, and it was later extended to all Indian citizens, including self-employed individuals. The scheme operates on a contribution-based system, where the individuals, whoever is interested in taking it up, can invest in the pension fund over time and this constitutes two different types of accounts, which are Tier 1 and Tier 2.

**TIER 1:** A non-withdrawable account to which the Subscriber shall contribute his/her savings for building a retirement corpus. This is mandatory.

**TIER 2:** A voluntary savings facility that provides liquidity to subscribers, i.e. subscribers will be free to withdraw their savings whenever they wish. This is optional.

This NPS system provides investment opportunities in various avenues like equity, corporate bonds, and government security and gives a wide opportunity for diverse portfolio development. Upon this retirement, a portion of the corpus is withdrawn as a lump sum and the remaining amount is used to purchase an annuity, and various sections like 80CCD (1), and 80CCD(1B) of the Income Tax Act can be availed. This scheme is regulated by the Pension Fund Regulatory and Development Authority (PFRDA), which ensures transparency and security. NPS is considered an affordable and efficient retirement solution for all investors

and individuals irrespective of income level and it gives an efficient retirement solution on a wholesome (International Labour Office, 2014). However, awareness and accessibility as well as challenges exist it is found that there is a limited adoption of NPS all over India.

NPS requires a minimum contribution of ₹500 per transaction, with an annual minimum of ₹6,000. Subscribers must contribute at least four times in a financial year. While there is no upper limit on the amount one can contribute, and no fixed periodicity is mandated, contributions can be made via cash, local cheque, or demand draft. However, transactions are only booked after the realisation of the cheque or demand draft, and outstation cheques are not accepted (Pension Fund Regulatory and Development Authority, 2022).

### **Steps Involved**

The process of pension planning can be understood as a step-by-step framework that begins with financial literacy as its foundation. The first step involves creating awareness among individuals about the importance of retirement planning. This awareness leads to a deeper understanding of various pension schemes, especially structured plans like NPS. With enhanced knowledge, individuals are better equipped to evaluate their options and make informed financial decisions. The final steps involve the actual adoption of pension plans and consistent contributions, which ultimately lead to improved financial security during retirement. This linear process emphasises the pivotal role that financial literacy plays at each stage of pension preparedness.

### ***Role of financial literacy in adoption of national pension scheme***

The adoption of NPS is significantly influenced and impacted by every individual's ability to face the structure, and benefits and attain the long-term impact it gives through financial literacy. It enhances the individual's knowledge to access all those various investment avenues within NPS, such as equity corporate bonds and government securities. The scheme is chosen based on the risk tolerance and the retirement goals of every individual and will attach to their preferences. Many individuals hesitate to take up pension schemes due to the misconceptions that are being spread by other peers and family members that they require high contributions and receive only low returns. Well-informed and financially literate individuals will understand the power and need of compounding and the relaxation that tax benefits provide them when they get associated with NPS. This scheme works as an attractive retirement saving tool in which individuals can compare the benefits of NPS with any other retirement saving options like EPF or PPF, which will help them to make quality decisions. Digital financial literacy plays a role in the adoption of online enrolment fund selection and portfolio building and monitoring which are key aspects of managing the National pension scheme. One disadvantage of NPS, which is seen among the individuals in the society is lack of financial knowledge, which makes them often rely upon some informal sources of advice, which gives a negative solution or advice to them, which will lead to suboptimal pension planning. Government initiatives and workplace pension awareness programs have to be initiated and the involvement of financial advisors can help to bridge this gap and add to the development of a National pension scheme in India (Thaler & Benartzi, 2004). To significantly enhance NPS participation the action that can be taken is by encouraging proactive financial planning through targeted campaigns and simplified pension-related communication that can strengthen financial literacy, it is very crucial because it is not just for increasing enrolment in NPS, but it ensures that there exists a better financial preparedness for retirement.

### ***Factors influencing pension planning decisions***

Pension planning decisions differ from individual to individual based on the preferences that make up their post-retirement benefits. Several factors influence the individual decision whether to participate in pension schemes like NPS or to choose an alternate scheme but the income level plays a very crucial part as higher earnings pave the way for higher contributions towards the retirement funds. Savings behaviour and financial discipline will determine whether the individual prioritises long-term security or the expenses that

they face in the journey (Agarwal et al., 2015). Risk perception will affect pension investment because certain individuals will avoid National pension schemes due to the fear of market-linked volatile movements. Government policies and tax benefits along with employer contributions can encourage the pension planning process and awareness and accessibility will influence the adoption rate of pension schemes especially in rural areas. While deciding to invest in pension plans, individuals might suffer from making decisions because of the short-term financial priorities that they may have like funds for education, healthcare, or repayment of loans take priority at that particular time over the long-term savings that could help them in their post-retirement. Other important factors, which also add up to the influencing factor, are social and cultural influences, family expectations, and peer influence as well as societal norms that are put upon the individuals which might shape their attitude and perception towards joining or enrolling in a retirement saving scheme. The positive influencing factor, which is seen in today's world is the technological advancement that happens every day, that is the digital platforms and fintech solutions make the pension investment and plans more accessible to individuals who need them. So, understanding these factors can help policymakers to design better strategies for increasing the adoption of NPS.

### ***Challenges faced about financial literacy on pension awareness***

Many individuals struggle to access pension schemes due to their limited financial literacy. While efforts to promote financial education continue, a significant portion of the population remains unaware of the importance of retirement savings. Many individuals prioritise their immediate financial needs over long-term retirement planning, leading to lower engagement with pension schemes. A major challenge is the lack of access to formal financial education (OECD, 2016). Complex financial jargon further discourages individuals from understanding pension schemes, creating a cycle of confusion and inaction. Additionally, misinformation about the risks and returns associated with pension plans contributes to hesitation in adopting schemes like NPS. Self-employed individuals and those in the informal sector face additional barriers due to irregular income streams, making it difficult for them to commit to long-term savings (Gallery et al., 2011). A lack of trust in financial institutions and pension fund managers further deters participation (Paskelian et al., 2019). Women and marginalised groups encounter even greater obstacles due to lower financial literacy levels and limited income, compounded by the inadequate reach of financial education programs (Nguyen et al., 2019) in rural areas. Employers and financial advisors play a crucial role in simplifying pension schemes and encouraging participation. Addressing these challenges is essential to improving financial preparedness for retirement, and ensuring broader access to pension benefits for all segments of society.

### ***Strategies to enhance financial literacy towards national pension scheme***

Improving financial literacy can play a crucial role in increasing pension planning awareness and boosting the adoption of NPS in India. Government initiatives, such as financial literacy workshops and awareness campaigns, can effectively educate individuals about the benefits of pension schemes. Integrating pension-related education into school and college curriculums can also have a long-term impact by instilling awareness in young individuals before they enter the workforce. Encouraging early adoption of pension schemes as soon as individuals start earning can significantly enhance NPS participation in the future. Banks and financial institutions should simplify pension-related information, ensuring it is easily accessible and understandable for individuals. Digital platforms and fintech solutions can further aid retirement planning by offering user-friendly resources tailored to different income levels. Additionally, employers can play a vital role by conducting pension awareness programs in workplaces and helping employees make informed decisions about their retirement savings. Collaboration between the regulator's financial advisors and the community leaders can improve the outreach of the national pension scheme into society. Social media usage in today's world is leveraging day to day and the online tools that can help in leveraging to spread pension literacy programs among the younger generation can also be encouraged in the society. Mobile application and pension calculation tasks can help individuals to make even more informed decisions about

the contribution that they have to make and the amount of corpus that they have to give every month or with relevance to the scheme that they choose and the expected return which they could enjoy by doing so. Introducing the NPS simulation tools for decision-making might create an interactive online portal that would stimulate different contribution levels and retirement benefits, and can help users to understand the long-term impact of their investment choices. Additionally, mandatory pension literacy sessions can be taken before the employment onboarding. The companies can include pension awareness as a part of HR onboarding programs and that could ensure that the employees are aware of NPS options from the start of their career. Incentives and tax benefits should be effectively communicated to encourage the participation of the individuals, a well-planned and tailored financial literacy strategy can enhance leading the society to a better financially secured life post-retirement.

## Conclusion

The National Pension Scheme is structured reliably for individuals to secure their retirement and to effectively enhance the adoption of NPS. Financial literacy plays a vital role in ensuring that the effect of pension planning is being done to sustain the long-term financial security of individuals. However, there is a lack of awareness, rotation of misconceptions and financial illiteracy altogether forms a wall in limiting the adoption of NPS in India, strengthening financial education through government initiatives (Chauhan, 2024), employer programs, and digital tools will help in bridging the gap. Simplifying the pension-related information and addressing the trust issues can enhance the adoption of NPS among the public and make them participate. The self-employed individuals and informal workers must be targeted in the awareness campaign must be delivered in an understanding and beneficial sense (Chatterjee, 2010). Integrating financial literacy into the education curriculum can significantly enhance awareness about pension schemes and encourage their adoption. Educating young individuals about the importance of retirement planning at an early stage can lead to better financial preparedness in the future. To achieve this, collaborative efforts between policymakers, financial institutions, and employers are essential. Such partnerships can help expand pension coverage by increasing awareness and providing accessible financial education (Sane & Thomas, 2015). By fostering a culture of early retirement planning, these initiatives can ensure greater participation in pension schemes and contribute to long-term financial security. The individuals can make better decisions for their retirement by ultimately contributing to a more financially secure future.

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