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A study of exempt funds in India

Renuka Sane      Namrata Harishankar\*

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## 1 INTRODUCTION

Most occupational pensions in India today, are funded through the schemes run by the Employees Provident Fund Organisation (EPFO) under the provisions of the EPF&MP Act 1952. The Act provides for three schemes for members in organisations with twenty or more employees earning upto Rs.6500 p.m. All the three schemes are a hybrid of DC and DB schemes, containing elements of both. The primary schemes are

- Employees Provident Fund (EPF): Under the EPF, the employee contributes 12% of his salary ,whereas the employer contributes 3.66% of the employee's salary. A guaranteed lump sum benefit is earned by the employee on retirement, as the yearly rate of interest accrued by the accretions are declared before hand
- Employees Pension Scheme (EPS): the scheme was designed to provide a monthly pension to qualifying employees of covered establishments at a replacement rate of roughly 50% of a maximum salary of Rs.6500 p.m. The scheme is financed through employers' contribution of 8.33% of the employee's salary to the pension fund.
- Employees Deposit Linked Insurance Scheme (EDLIS): This is an insurance scheme that pays the survivor of the member an amount in proportion to the balance in the members PF.

The EPFO, is responsible for the management and supervision of the three enumerated schemes. All organisations hand over the collected contributions to the EPFO, which is responsible for both, the investment and disbursement of these funds. The Act however provides for establishments to seek an exemption from the EPFO. There are provisions of two kinds of exemptions: one is an exemption from the Act itself, and the other is an exemption from the operation of one or more of the schemes under the Act. This document describes in detail the provisions and processes for exemption from the operation of the schemes of the EPFO. Section 2 describes the legislation for grant of exemption. Section 3 talks about the procedure for establishing an exempt fund. Section 4 talks about the coverage of exempt funds. Section 5 deals with the operational framework of an exempt funds covering issues like administration, benefits and funding. Section 6 talks about the regulatory structure under which the exempt funds operate. Section7 concludes.

## 2 EXEMPTION FROM THE ACT

The EPF&MP Act 1952 placed the sole responsibility of management of the three schemes on the EPFO. Under Section 17 of the Act, the government has the authority to grant exemption to an establishment from all or any

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Table 1: Membership of exempt funds as a % of organised employment

Year	% of organised employment	% of population
1997	16.04	0.48
1998	15.65	0.46
1999	14.9	0.46
2000	15.5	0.43
2001	15.32	0.42
2002	14.23	0.38

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Source:EPFO Annual reports and CMIE

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of the provisions of any scheme under certain conditions. It is not the *right* of an employer to demand an exemption. The employer can only seek an exemption and the government *may* grant one. The important thing to note is that the establishment is only exempt in an administrative sense: it can run its own provident fund scheme, pension or insurance scheme only if it provides benefits at least as good as those provided by the EPFO. It is still obliged to follow investment guidelines as set by the EPFO and is also subject to periodic inspections by the EPFO. Table 1 shows the membership of the exempt funds as a percentage of organised employment and as a percent of population.

### 3 ESTABLISHING AN EXEMPT FUND

The EPF&MP Act 1952 placed EPFO at the helm of affairs. All transactions such as contributions, transfers from one firm to another, withdrawals were to be routed through the EPFO. Many organisations were of the view that establishing trusts and administering the benefits themselves would be more efficient and less cumbersome than dealing with the bureaucracy of the EPFO. However, an establishment seeking an exemption has to go through a rigorous exemption procedure. The establishment has to follow different rules for each of the three schemes. As of date, exemption is primarily given for the EPF (provident fund scheme) followed by exemption for the EDLIS (insurance scheme). Very few exemptions are given for the EPS (pension) scheme.

### **3.1 Rules for exemption**

Any establishment seeking an exemption has to abide by certain rules.

#### **3.1.1 Rules for exemption from EPF**

Provisions for exemption from EPF are listed in Section 17 of the EPF&MP Act 1952 along with Section 27 of EPF 1952. The provisions for exemption from EPF have been in force from 14 October 1953. An establishment seeking an exemption from EPF is required to provide for contribution rates that are not less favourable than those set by the EPFO. The lump sum benefit provided is also expected to be at least at par with the benefit provided by the EPFO. Every year the government announces an interest rate for its members. This interest rate then becomes a floor for the exempt funds—they can credit a higher interest rate, but not a lower one. In 2002-03 this translated into an interest rate of 9.0% + a bonus of 0.5%. The establishment to which the exemption is granted is required to pay inspection charges at 0.18% of total wages on which Provident Fund is recovered, to the Regional Provident Fund Commissioner (RPFC).

#### **3.1.2 Rules for exemption from EPS**

Provisions for exemption from the EPS are notified under Section 17 of the EPF&MP Act '52 along with Section 39 of EPS 95. An exemption is granted from the EPS, if and only if the establishment can provide benefits in the nature of a pension, which is at par or more favourable than those provided by the EPFO. Exemptions from EPS have been rare, only three so far, as it is believed that the capacity of an organisation to provide for a pension (effectively a life and survivor annuity) to its employees is limited.

#### **3.1.3 Rules for exemption from EDLIS**

Provisions for exemption from the EDLIS are under Section 17 of EPF&MP Act '52 and Section 28,(1) of EDLIS 76. An exemption from EDLIS is granted where the employees receive an insurance benefit without making any separate contribution or paying premium. It is necessary that this insurance benefit be greater than the insurance benefit provided under the EDLIS. An establishment exempted from the operation of the EDLIS 76 is required to

submit a *monthly return* to the RPFC. The establishment is also liable to pay inspection charges at the rate of 0.005% of the basic wages and dearness allowance, subject to a minimum of Re.1/- per month.

## 3.2 Procedure for seeking an exemption

### 3.2.1 Old organisations employing 20 people or more, seeking exemption

There is no minimum limit prescribed for the number of employees that a firm must have before seeking exemption. The exemption is granted primarily on the grounds of the contribution rates and benefits provided by the trust provided it has been recognised by the Income tax department. The process of seeking exemption though, is cumbersome. All organisations must abide by the rules detailed below

- Comply as unexempt organisation for a *specified period* of time, and pay all dues to the EPFO
- Organisations seeking exemption from EPF, must set up a Provident Fund Trust
- They must apply for, and obtain recognition from the Commissioner of Income Tax
- they must apply to the Regional Provident Fund Commissioner (RPFC) with the following:
  - Pro-forma of application
  - Details of contractors
  - Consent signatures of majority<sup>1</sup> of employees
  - Comparison between the trust rules and rules under the PF Scheme
- Undergo a formal inspection by the RPFC

RPFC forwards its recommendation to the Central Provident Fund Commissioner (CPFC) after multiple iterations of queries and clarifications. The CPFC after scrutiny forwards its recommendation to the Ministry of Labour or the State Government. The Ministry of Labour or State Government notifies the exemption in the official gazette.

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<sup>1</sup>Majority of employees includes consent of at least 51% of employees. However, an employer is required to satisfy in writing a query or a complaint raised by even one employee before he is granted exemption.

### 3.2.2 New organisations having 20 or more employees

A number of new companies (IT, Multinationals, etc) that have large growth plans prefer to provide retirement benefits including Provident Fund by setting up a private trust from day one. However, these companies are forced to comply as unexempt for their application for exemption to be considered. This involves

- Transfer of all the balances in the private trust to EPFO.
- Remittance of contributions to EPFO, till grant of exemption.
- Transfer of individual accumulations back to the Exempt Trust (after obtaining exemption).

### 3.2.3 Rules applicable in the interim period before exemption is granted

- All provisions of the EPF&MP Act 1952 apply to establishments during the interim period till the decision is made.
- The rate of contribution applicable, however, is the rate stated in the establishment's provident fund rules and not the rate mandated by the EPF&MP Act 1952.
- In case exemption from EDLIS is sought, during the interim period
  - Employees are entitled to enjoy benefits of both schemes, the EDLIS as well as the group insurance scheme set up by the employer.
  - Employers are required to continue paying inspection charges to the EPFO at the rate of 0.005% of employees' basic wages and dearness allowance.

In case of denial of exemption, the liability of the establishment is effective from the date the scheme was notified and not from the date of refusal of exemption by the government.

The government which has the authority to grant exemption, along with the CPFC or the RPFC also has the right to impose certain conditions over and above those specified in the Act. The government can also revoke exemption if it finds that the exempt fund is not performing well.

## 4 COVERAGE OF EXEMPT FUNDS

The total number of exempt establishments in the year 2002-2003 were 2564, of a total of 344,508 establishments covered under the EPF&MP Act 1952.

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Table 2: Number of exempt establishments

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Year	No	Percent of total
1994	3109	1.31247
1995	3143	1.25213
1996	2934	10.9282
1997	2970	1.07006
1998	2948	0.985281
1999	3123	0.980749
2000	2805	0.859004
2001	2624	0.771735
2002	2590	0.723975
2003	2564	0.74425

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Source: EPFO Annual reports

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The exempt funds therefore represent 0.744% of the total establishments. In terms of the corpus of EPF funds, the contributions of the exempt sector vis'a vis total contributions is 33.88%. The percentage of total members belonging to the exempt institutions are 9.49%. This therefore implies that the establishments exempt from the EPF primarily employ a larger number of employees who are on higher salary scales, which explains the larger proportion of contributions. Table 2 shows the total number of exempt establishments and the number of exempt establishments as a percent of total. The number of exempt establishments has been steadily declining in absolute numbers as well as in terms of % of total. This is so because the EPFO has categorically denied exemption status to most applications. The primary reason provided by the EPFO is that this is a precautionary measure against fly by night operators who have contributed irregularly in the past and been unable to meet the statutory rate of interest. Defaults on payments involves complicated modes of recovery and is an administrative nightmare (See Table 3 for defaults of exempt funds). The compliance record of unexempt funds has not been significantly better than that of the exempt funds.

At the same time one could also argue that the EPFO is eager to not lose a steady revenue source in the form of fund management and administrative charges paid by employers. Earlier regulations had placed greater power in the hands of the RPFC by enabling them to grant 'relaxations'. These relaxations entitled establishments waiting for approval, to not pay the administrative charges and instead begin operating the exempt trust. This

Table 3: % of defaulting exempt and unexempt establishments		
Year	Exempt funds	Unexempt funds
1994	5.21068	4.98734
1995	4.45434	4.77508
1996	5.21472	4.40183
1997	11.0101	7.71892
1998	11.8046	7.09083
1999	13.8329	5.93897
2000	18.2531	6.54515
2001	10.747	7.68401
2002	9.96139	8.80287
2003	10.6864	8.62802

Source: EPFO annual reports

power has recently been withdrawn. Hence all such establishments are supposed to comply as unexempt till approval. However Para (79) of the EPF&MP Act '52, grants the Commissioner the power to relax the provisions of the scheme to any establishment which has applied for exemption. It remains to be seen under what amendment have the 'relaxations' been withdrawn. The Act also specifies that the Board has to give a view on grant of exemption within three months of receipt of proposal for grant of exemption. One does not know whether this is followed in practice. It would do the EPFO and the establishments a lot of good, were smoother procedures devised for grant of exemptions. If the Board, within, three months, fails to give a decision, the establishment should be deemed to have been granted the status of an 'exempt fund'.

#### 4.1 Regional distribution of Exempt funds

Presently, the regional concentration of exempt funds is skewed against the north, as more than 40% are concentrated in the three states of Maharashtra, Karnataka and West Bengal. This is displayed in Table 4.

Table 4: Regional Concentration of Exempt Establishments - 2003				
Region	Members		Establishments	
	No.	% of Total	No.	% of Total
Karnataka	334206	8.9	157	6.12
Maharashtra	698728	18.62	463	18.06
West Bengal	568088	15.14	654	25.51
Rest of the Regions	2150200	57.34	1290	50.31
Total Strength of 21 Regions	3751222	100	2564	100

Source: EPFO Annual reports

## 5 OPERATIONAL FRAMEWORK OF AN EXEMPT FUND

### 5.1 Administration

The trust system was established in order to secure independence from the employer. The trust lies at the centre of all the activities of the exempt fund. The trust equally represents both the employers and the employees of the establishment. The rules identify the minimum number of trustees required to be appointed. These trustees are chosen through an election conducted every three years. It is common practice for the CFOs and HR heads to be part of the board representing employers, whereas employees are represented by Union representatives. However the HR heads and CFOs rarely have the time to attend meetings and though quarterly meetings are compulsory, in most cases, they are a mere formality, recorded to fulfil legal requirements.

The trust acts as custodian to the collective contributions of all employees and employers. As almost all exempt funds are PF trusts, 12% of the employees' contribution and 3.66% of the employers' contributions flow to the trust, along with the additional contribution towards the insurance scheme, if exempt from EDLIS. The remaining contributions are forwarded directly by the employer to the EPFO. The trust manages the money received in accordance with the investment guidelines applicable to it. The trust is also responsible for handling transfers of employees in and out of the exempt fund, and for payment of terminal benefits to retirees. Fund management is not a necessary function of the trust. The option of outsourcing fund management is available, and is increasingly being witnessed. There is no cap on the rate

of interest that can be declared by a trust, as long as it is at par with the rate declared by the EPFO. However, PF accumulations accruing interest at a rate higher than the rate declared by the EPFO rate, are not tax exempt.

The freedom, of an exempt fund is administrative in nature. The EPFO is responsible for strict supervision of all the activities of the trust. These regulatory mechanisms have been discussed subsequently. The EPFO charges the exempt funds inspection fees in order to fulfil its role as a supervisor. As of 2004 this was 0.18% of wages. The payment of these charges is the responsibility of the employer and not the trust. As exempt funds are meant to function as trusts, they must follow the guidelines of the Indian Trusts Act. These exempt trusts are also required to comply with the provisions of schedule IV of the Income Tax Act, in order to be treated as tax-exempt.

## 5.2 Benefits

### 5.2.1 Organisations exempt from EPF

Exempt funds must provide benefits that are at least as favourable as the benefits enjoyed by employees under the EPF. These benefits rarely deviate from those already being provided by the EPFO. The withdrawal options in particular are the same as those applicable to unexempt establishments. The minimum level of benefits therefore, that the fund must provide should be the benefits enjoyed by EPF members. The advantage of exempt trusts however lie in the intangibles. Expediency is a key advantage, as funds are managed in-house, employee requests are processed much quicker. The benefits and withdrawal options are as follows:

- A member of the provident fund can withdraw the full amount of the credit in the fund on retirement from service, after attaining the age of 55 years.
- Premature full withdrawals of accumulations are allowed in the case of the following contingencies:
  - A member who has not attained the age of 55 year at the time of termination of service.
  - A member who has retired on account of permanent and total disablement due to bodily or mental infirmity.
  - When a member migrates from India for permanent settlement abroad or for taking employment abroad.
  - When mass or individual retrenchment occurs.

Table 5: Withdrawals by members of exempt funds

Reason	Nos	Amount (in lakhs)
Financing LIC policy	6618	831
Housing advance	124940	165789
During temporary closure	23387	7357
Illness of members/family members	142102	29669
Member's own marriage	107947	68354
Withdrawal one year before retirement	21761	17837
Others	102247	99910

Source: EPFO Annual Report 2003

- The payment of the entire amount accumulated in the provident fund is also made if a member having completed a *continuous period of at least two months*, applies for withdrawal in the following circumstances:
  - When employees transfer from the exempt establishment to an unexempt one
  - When a member is discharged and is given retrenchment compensation under the Industrial Dispute Act, 1947.
  - When an employee transfers from an exempt establishment to an excluded trust<sup>2</sup>

It has often been observed that due to rules that permit withdrawals, provident fund is used more to finance claims during working life and less to finance consumption in old age. This diminishes the purpose of the fund of providing social security in old age. Table 5 shows the withdrawals seen by members of exempt funds in 2003.

### 5.2.2 Organisations exempt from EPS

Employees of organisations exempt from EPS (currently three<sup>3</sup> in number) have to be provided with benefits that are at least as favourable as in the EPS scheme. Employees of organisations exempt from EPF, but subscribing to EPS, enjoy all benefits as mandated by EPFO under the EPS scheme. Members are eligible for EPS benefits only after a minimum of 10 years of service, and on attaining 58 years of age. On death of the member, survivor benefits are provided to the widow/widower and to children till the age of 25

<sup>2</sup>An excluded trust is a trust formed for employees who earn more than Rs.6500 per month and are not a part of the EPFO.

<sup>3</sup>These are Tata Motors, Oil India and Malaysian Airlines

The member's pension is calculated at the rate of 1/70th of the pensionable salary, for each year of service. Pensionable salary is the salary drawn during the contributory period of service in the span of 12 months preceding the date of exit from the membership of EPF. The pensionable salary is capped at Rs.6500. If an employer has chosen to make contribution to EPF on full salary, ignoring the salary ceiling of Rs 6500 p.m., he has the option of making contribution to EPS either on full salary or on salary with the ceiling of Rs.6500 p.m. and the pension would then be based on the corresponding salary

If a member retires before turning 58, he has the option of drawing his pension before attaining the age of 58 years of age but not before attaining the age of 50 years . Such early pension will be subject to *discounting factor*. However, no such age restriction or eligibility requirement shall apply for pension entitlement on disablement or pension payable to the family members on death of the member. Membership with one contribution is enough in such cases.

In principle, if an employee changes jobs, the EPS contributions made by the previous employer are added to present contributions. In practice, however, this has not always happened. Instead, only contributions made in the last job, preceding retirement, have been annuitised.

### 5.2.3 Organisations exempt from EDLIS

Establishments that are covered under the EPF&MP Act 1952 and are exempt from the EDLIS are mandated to provide benefits to their employees that are at least as favourable as those enjoyed by employees of establishments that are unexempt. The benefit that unexempt institutions provide is called the Assurance Benefit. On the death of the member while in service, ( the employee should be on the payroll of the company at the time of death) the nominee or any other person entitled to receive the Provident Fund benefits, also receives the Assurance Benefit. The nominee receives the full amount, equal to the average balance in the account of the deceased in the preceding 12 months subject to a ceiling of Rs.35000. If the average amount in the account exceeds Rs.35000, then 25% of the average balance in excess of Rs.35000, is payable to the nominee in addition to Rs.35000. The total amount payable in the latter case is subject to a ceiling of Rs.60000.

The benefits detailed above are only provided to employees earning up to Rs.6500 p.m. For employees earning above Rs.6500, benefits are usually

provided from a separate, employer sponsored group insurance scheme or through individual insurance schemes purchased by employees themselves.

### **5.3 Taxation policy**

The contributions made by employers at the specified rates, are tax deductible in the employer's tax assessment.

The contribution made by the employer on behalf of the employee is not considered a prerequisite in the tax assessment of the employee and is hence, tax free. The employees' own contribution is eligible for a tax rebate as per Section 88 of the Income Tax Act, 1961. If the employee leaves service before completing 5 years, any lump sum withdrawn by him is taxable. The employers' contribution is taken as income in the hands of the employee and taxed accordingly. In case of withdrawal from service after a minimum of 5 years the full lump sum is tax free.

The investment income and capital gains that accrue to the investments made by the trust fund are free of tax.

### **5.4 Funding**

#### **5.4.1 Contribution Rates**

The contributions towards the the establishments PF scheme must at least be at par with the EPFO schemes. A total contribution of 12% (of basic + D.A.) each from the employer and the employee is mandatory according to EPFO. For establishments exempt from EPF a minimum contribution of 12% by the employee and 3.66% by the employer is required. The remaining 8.33% of the employers' total 12% contribution is passed on to the EPFO, towards the EPS. For the insurance scheme, the act mandates that the employer's contribution be higher than the statutory 0.5% of the basic wages and DA of the employee.

#### **5.4.2 Statutory rate of interest**

Under para 60(1) of the EPF 1952, the Central Government on the recommendation of the Central Board of Trustees, declares the rate of interest to be credited to the members account annually. (See Table 6) In recent

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Table 6: Interest rate declared by the EPFO

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Year	Rate of interest
1995-96	12.00
1996-97	12.00
1997-98	12.00
1998-99	12.00
1999-00	12.00
2000-01	11.25*
2001-02	9.50#
2002-03	9.50#

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\* For exits upto June 2001, the interest rate credited was 12%. Beyond June 2001, the interest rate credited was 11.25%.

# EPFO has not declared the rate of interest for the two years.

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Source: EPFO Annual reports

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times, there has been demand by trade unions to raise this interest rate back to its previous levels of 12%, but given the falling interest rate scenario in the market, this does not seem wise or likely.

#### 5.4.3 Regimented investment regime

The EPFO not only mandates the interest rate that must be credited by the exempt fund to the member, but also mandates the investment pattern for the trust. This pattern is highly skewed towards government (both state and centre) securities. In recent times investment in gilt funds run by mutual funds has been permitted upto a certain extent. Table 7 shows the investment pattern mandated by the EPFO. EPFO rules also do not permit active management i.e. trading on the secondary market. As a result scrips once brought have to be held to maturity. Sale of securities can only be effected after approval from the RPF commissioner. All interest earnings of an asset class must be reinvested into the same asset class. This investment regime is found to be highly restrictive. The exempt funds have found it difficult to keep up to the mandated interest rates with such an investment regulation. There is believed to be a need for flexibility in either one: interest rate or the regulations for investments.

Accordingly the pattern of investments observed in various instruments as a percentage of total gross investments is given in Table 8

Table 7: Investment pattern of the EPFO

Investment pattern	% to be invested
i) Central government securities as defined in Section 2 of the Public Debt Act, 1944 and/or units of mutual funds which have been set up as dedicated funds for investment in g-secs and which have been approved by SEBI	25%
ii) a) government securities as defined under section 2 of the Public Debt Act 1944 created and issued by the State government and/or units of such mutual funds which have been set up as dedicated funds for investment in govt. securities and which have been approved by the SEBI and or b) any other negotiable securities the principal whereof and interest whereon is fully and unconditionally guaranteed by the central government or any state government except those covered under iii)(a) below	15%
iii) a) Bonds/Securities of Public Financial Institutions as specified under Section 4(1) of the Companies Act, "Public Sector Companies" as defined in Section 2(36-A) of the Income Tax Act, 1961, including public sector banks and/or Short duration (less than a year) Term Deposit Receipt (TDR) issued by public sector banks	30%
iv) To be invested in any of the above three categories as decided by the Board of Trustees	30%
v) The Trusts, subject to their assessment of the risk return prospects, may invest up to 1/3rd out of (iv) above, in private sector bonds/securities which have an investment grade rating from at least two credit rating agencies	

Source: Ministry of Labour, 2003

The Special Deposit Scheme (SDS), a non-tradable deposit account introduced in 1975, was a runaway success. The outstanding balances in

Table 8: Observed investments of exempt funds  
 % of gross investment

Year	Central Gses	State Gsecs	SDS	PSUs
1994	11	3.5	85	0
1995	11.15	6.42	82.44	0
1996	21.60	16.88	44.51	16.99
1997	12.94	20.09	35.01	31.94
1998	13.28	17.18	30.45	39.07
1999	17.83	21.93	26.12	34.10
2000	22.57	23.22	24.45	29.75
2001	26.74	25.17	19.04	29.04
2002	22.28	20.69	23.46	33.55
2003	24.87	21.11	17.21	36.79

Source: EPFO Annual reports

these accounts earned interest at a rate, administratively determined by the central government from year to year. This scheme however, was discontinued in 1997-98. In 1998-99, for the first time, investment was permitted in bonds of private sector enterprises. The bonds however, had to carry an investment grade rating from at least two credit rating agencies. Despite the freedom to invest in bonds of private sector enterprises, exempted funds did not choose to do so as government guaranteed (implicitly or explicitly guaranteed) bonds were considered safer. After the closing of the SDS, investments shifted towards state government securities and securities of government enterprises. A majority of exempt fund investments seem to be held in PSU bonds and central government securities.

The other problem with the investment regime is that the PF Trusts' access to live prices and AAA rated assets are restricted as such assets are rarely traded in retail lots. Market lots (inter-bank lots) for bonds are INR 50 million and above. Retail lots are illiquid and are therefore priced at 5 bps to 50 bps lower. Most provident funds do not have investible surpluses of INR 50million. Recent SEBI regulation restricts number of investors in primary issues to 49 and most AAA bond issuers comply. This restricts access to such bonds for PFs and they are left with bonds of riskier and lower rated Government Companies, the likes of electricity boards and irrigation projects. Provident funds are forced to buy securities from smaller brokering firms who pose settlement risk.

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Table 9: Establishments that did not declare interest rate rate

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Year	Less than statutory rate	Undeclared
1994	61	115
1995	261	533
1996	113	565
1997	229	465
1998	85	338
1999	54	461
2000	44	673
2001	37	617
2002	30	583
2003	17	918

Source: EPFO Annual reports

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#### 5.4.4 Falling interest rate of g-sec yields

Closing down the SDS and falling yields of central government securities have made it difficult for exempt funds to meet the stipulated 9.5% interest rate mandated by the EPFO. The number of organisations who have failed to declare the interest rate, has been increasing with time, as is shown in Table 9. Most funds earned on their investments until the last few years when interest rates started falling. They have managed to credit 9.5% using the surpluses earned in the past. However, if interest rates continue falling and old high interest paying bonds near maturity, employers will find it difficult to keep up to the 9.5% interest rate. It is also a commonly held belief around the market that funds tend to invest in junk bonds or bonds with lower credit ratings in a bid to meet the high interest rates. This raises the question of viability of these exempt funds.

## 6 REGULATION OF EXEMPT FUNDS

The EPFO is the supervisory body of the exempt funds. The regulation is derived primarily from three Acts:

- The EPF&MP Act, 1952
- The Income Tax Act, 1961

- The Indian Trusts Act, 1882

The chief regulatory mechanisms employed by the EPFO are:

- The Trust System, which ensures independence from the employer
- Submission of monthly reports: The trust maintains a detailed record of all its activities in the form of monthly reports submitted to the EPFO. These monthly reports carry information on all the outflows and inflows during the month. Hence they contain data on aggregate contributions collected, investment made (money must be invested by the 15th of the month), terminal benefits paid and transfers settled.
- Annual inspection by EPFO: The trust is also subject to at least one inspection a year, by the EPFO. It is also expected to issue to its members at least one statement of accounts a year

## 6.1 Delayed payments and defaults

In order to safeguard the interests of employees the contribution payable by employers are treated as statutory liabilities, and given priority over all other debt if insolvency occurs. Criminal charges can be imposed against the directors in such a situation. However, the amount accumulated in a member's provident fund, and amount payable under the pension/insurance scheme is protected against attachment, in the case of insolvency. Even in the event of death of a member, immunity is granted, and the amount shall accrue to the nominee. (Section 10, EPF&MP Act 1952). Table 10 shows arrears of public and private sector organisations over the years.

Delayed payments and defaults can lead to the imposition of penalties. These are listed in Appendix A.

withdrawals and interest accruals

## 7 CONCLUSION

Contracting out of the EPFO in principle would indeed provide a great deal of flexibility to employers to constitute and administer provident and pension funds for the employees. The EPFO has taken several initiatives for reform and once constituted, there should be significant change in the functioning and performance of the EPFO and also of exempt funds. However, there is still considerable information required regarding the functioning of exempt funds. For example, it would be useful to know the portfolio distribution of

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Table 10: Arrears of exempt establishments  
(in Rs.crore)

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Year	Public sector	Private sector
1994	94.00	102.08
1995	62.31	93.62
1996	77.36	104.98
1997	70.27	94.19
1998	91.82	85.97
1999	129.31	105.55
2000	214.71	254. 41
2001	371.68	45.89
2002	232.55	150.65
2003	271.56	168.36

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Source: EPFO Annual reports

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exempt funds and the credit ratings of the instruments held by them. This will help the EPFO in getting an estimate of the viability of exempt funds.

## APPENDIX A

- If payments are delayed by the employer, a simple interest at the rate of 12% or higher (subject to mkt lending rate) will be payable by the employer.
- When arrears occur, the authorised officer may issue, to the Recovery Officer, a certificate under his signature specifying the amount of arrears and the Recovery Officer, shall proceed to recover the amount specified therein from the establishment or, as the case may be, the employer by one or more of the modes mentioned below: (a) attachment and sale of the movable or immovable property of the establishment (if revenues obtained after sale are insufficient) or, the employer; (b) arrest of the employer and his detention in prison
- Money owed by person to employer: When money is owed by a person to an employer in arrears, the authorised officer shall direct the person to deduct the amount of arrears and pay the same to the credit of the authorised officer. Any person to whom such notice is issued is bound to comply with the same, including a post office, a bank or an insurer. Any person who fails to make payment in pursuance of a notice shall be deemed to be an employer in default and liable to be proceeded against in the same manner as an employer who is in arrears.
- If any money belonging to the employer is in custody of a court, the Central Provident Fund Commissioner or other authorised officer may apply to the court for payment of amounts in arrear from the employer.
- Recovery by sale of property: Where so authorised by the Central Government by a general or special order, the Central Provident Fund Commissioner or any officer not below the rank of an Assistant Provident Fund Commissioner may recover the arrears from any establishment or employer by sale of its or his movable property in the manner laid down in the Third Schedule to the Income Tax Act 1961.
- Priority of dues in the event of insolvency or winding up Dues of the employer under the Act shall also have priority over other debts in the event of adjudication of the employer as insolvent or in the event an order for winding up is made in the case of an employer who is a company (Section 11). Such priority would apply even though dues under the Act may be unsecured.
- The Central Provident Fund Commissioner has framed guidelines for acceptance of arrears in installments for companies in financial difficulties, especially in the case of companies, which are declared sick by the Board for Industrial and Financial Restructuring (BIFR).
- There is, however, no provision in the Act imposing responsibility on the Exempted Funds to initiate punitive recovery procedure where arrears are pending for a long period.