

Employer Pensions in India; Status and Reform Agenda

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1 INTRODUCTION

The current pension reform agenda tends to focus narrowly on the government and individual segments and occupational plans like superannuation, gratuity and provident fund are dangerously neglected.

The reform program needs to make the leap that science made from classical physics (discrete systems) to quantum physics (everything is interdependent) and flip around the current over-regulation and under-supervision. Most importantly, it is time to tackle the difficult and politically sensitive issue of reforming Provident Fund.

The dual and conflicting role of the Provident Fund commissioner as regulator and administrator needs urgent splitting. Employers currently pay 4.4% of contributions as administration fees and the current structure does not subject their fees or services to any competition. The issue is not public versus private but competition versus monopoly. Other issues like lifting the ban on exemptions, scrapping EPS and linking investment returns to market will be inevitable concomitants of a role separation.

Sequencing reform is key and shifting investment reform to the next phase may be pragmatic. It is hard to make a case for equity today though there is no doubt that it is long term inevitable. But pension reform is always politically sensitive and if we propose a radical 0 or 100 we will often get zero. We need to realize that compromise reform is better than no reform.

Base camp for any reform program is an independent and integrated regulator. Only such a body will be able to balance the multiple, often conflicting, objectives of the current kingdoms of the Ministry of Finance, the Employees Provident Fund Organization, Ministry of Labor, Securities and Exchange Board of India, Central Board of Direct Taxes, etc.

There are a number of tactical and administrative issues related to occupational pensions that have been detailed in the paper. However, we believe that most of them will be resolved very efficiently as soon as a clear and independent regulatory framework is put in place.

2 PROVIDENT FUNDS

2.1 Background

The Provident Fund is a Mandatory Retirement Benefit required to be provided by all employers with more than twenty employees under the Employees Provident Funds and Miscellaneous Provision Act, 1952 (PF Act).

The Employees Provident Fund Organization (EPFO) headed by the Central Provident Fund Commissioner administers and regulates all employee benefits. This organization is part of the Labor Ministry at the Central Government. A politically nominated Board of Trustees makes policy decisions. The Provident Fund Act provides three benefit buckets for participants:

Employees Provident Fund Scheme (EPF) : The employee contributes 12% of his monthly PF Salary (Basic + Dearness Allowance) towards this fund and the employer matches this contribution. This is accumulated as a lump sum. The corpus of this scheme earns an administered rate of return every year (For 2000-2001 it was 9.5%). The accumulation with interest is paid back on retirement. There are multiple scenarios (marriage, mortgage, medical, etc) which allow for early access to the accumulation.

Employees Pension Scheme (EPS) Of the 12% contribution payable by the employer, 8.33% is diverted to EPS and the Central Government contributes a subsidy of 1.16% of the PF Salary into EPS. This accumulation is used to pay various pension benefits on retirement or early termination. However, if the PF salary is more than INR 6,500/-, contributions towards the EPS are calculated with that cap as base.

Employees Deposit Linked Insurance Scheme (EDLI) This is more of social security; in the event of death of an employee, his dependents are paid an insurance linked to the PF accumulation available to his credit. Contributions at the rate of 0.5% of PF salary come only from the Employer and is capped at INR 6,500/- An important point is that the employer pays all fees, charges, etc for the administration of this entire plan (over and above the contribution). The accumulated fund is currently not debited with any administration or management costs. Employers are also required to submit information on member movement (jonees, resignees), total contributions, etc on a monthly and yearly basis.

3 EXEMPT PROVIDENT FUND TRUSTS

3.1 Background

Acknowledging that some employers did not want to hand over the management and administration of their employee benefits to EPFO, the PF Act provided for employers the option to set up their own exempt PF Trusts after going through a formal and somewhat cumbersome (originally meant to be rigorous) process of approval.

The PF Act allowed for three kinds of exemptions

1. *Individual employee exemption* An employee could apply to the Regional Provident Fund Commissioner stating that the employer provides PF benefit better or equal to EPFO by running a trust and hence the employee should not be forced to pay into the EPFO and be allowed to pay into the employer's PF trust
2. *Exemption for a class of employees* The employer sets up a PF Trust that has restrictive membership to a category of employees e.g. managers, workers, staff, etc. All other un-exempt categories are required to comply by remitting monthly contributions to the EPFO.
3. *Exemption for the employer as a whole* The employer sets up a trust that will cover the entire employee population including the employees of contractors.

The relative balance of exempt and un-exempt institutions is given in Table 2

In 1952, when the scheme was set up, most employees were covered under some kind of Exempt Trust. Over time, aggressive growth by the EPFO and a go-slow in exemptions by the EPFO has radically altered the relative balance. This trend has particularly accelerated in the last few years.

Why Employers Prefer Exempt PF Trusts

With provident funds being part of cost-to-company (CTC) and employees wanting more information, control and access, employers prefer managing exempt trusts. The corporate landscape is a lot more volatile with restructuring, merger, and acquisitions, etc., becoming more common today than before. This coupled with the highly mobile labor market and employees

Criterion	Within the PF Act		Outside the PF Act
	Unexempt	Exempt	Excluded
Eligibility	All employers with more than 20 employees, All employees covered under the PF Act	All employers with explicit exemption from EPFO All employees covered under the PF Act	Voluntary for Employers Only Employees with more than Rs 6500 (Basic Salary) and no previous EPFO balance
Salary used for calculation	Basic + Dearness Allowance	Basic + Dearness Allowance	As per trust rules
Contributions	EPF Employer-3.67%, EPF Employee -12.00%, EPS Employer-8.33%, E DLI Employer -0.50%, EPS Govt.-1.16%, Total- 25.66%	EPF Employer-3.67%, EPF Employee -12.00%, EPS Employer-8.33%, E DLI Employer -0.50%, EPS Govt.-1.16%, Total- 25.66%	PF Employer-12.00%, PF Employee-12.00%, (Trust rules could provide for a lesser rate), Total- 24.0%
Contribution Payable to	EPFO	PF Contributions to the Trust and the rest to EPFO	Entire Contribution payable to the Trust
Other Charges Administration	PF Admin 1.10%, EDLI Admin 0.05% EPFO	PF Inspn 0.18%, EDLI Admin -0.05% Trustees representing employer and employee	No Charges payable Trustees representing employer and employee
Benefits Regulator	EPF, EDLI, EPS EPFO	EPF, EDLI, EPS EPFO and Income Tax Commissioner	Provident Fund Income Tax Commissioner
Coverage	On crossing twenty employees	On approval by the EPFO	At the option of the employer
Investment Returns	Rate fixed by the EPFO	At least equal to rate Fixed by EPFO	Rate to be decided by the Trustees; determined by the return on corpus
Asset Allocation	As per Labor Ministry Notification	As per Labor Ministry Notification	As per Finance Ministry Notification
Taxability	EEE (No Tax at any stage)	EET (Taxable only if withdrawn before 5 years of membership)	EET (Taxable only if withdrawn before 5 years of membership)

Table 1: Options for Employers

	Employers Covered		Employees Covered					
	No(000s)		% total		No(mill)		% total	
Years	1986	2001	1986	2001	1986	2001	1986	2001
Exempt	2.79	2.62	1.77	0.77	4.02	4.28	30.45	15.89
Unexempt	155.07	337.39	98.23	99.23	9.18	22.66	69.55	84.11
Total	157.86	340.01	100.00	100.00	13.20	26.94	100.00	100.00

Table 2: Relative balance of exempt and unexempt institutions

Year	Exempted employers		Exempted employees	
	No.(in 000s)	Change	No. (in mil- lions)	Change
1986	2.79		4.02	
1996*	2.93	0.14	4.58	0.56
1999**	3.12	0.19	4.11	-0.47
2000**	2.59-0.53	4.36	0.25	
2001**	2.62	0.03	4.28	-0.08

*From Prof. Mukhul Asher's research based on EPFO Annual Reports

* Annual Accounts of EPFO for the year 2001-2002

Table 3: Coverage of exempt establishments

seeking easy portability of their benefits, a monitored exempt trust would work best.

The Business Case being there is a huge direct cost saving (this not including the indirect cost of follow-ups with Regional Provident Fund Commissioner) for employers relative to un-exempt compliance. (Refer Table 4)

Further, the service levels of the EPFO, though improving, have a number of interface points and cumbersome procedures. (Refer Table 5)

The Government mandates the Investment Returns while exempt funds have the flexibility to give higher returns by better cash flow and fund management. The onus of paying the minimum guaranteed return shifts from the EPFO to the employer in an exempt trust. This may not be a real threat now as interest rates credited by EPFO slide in relation to market rates. The subsidy, if any, is now limited to a time lag in adjustment to market rates.

	Un-Exempt	Exempt	Savings
Administration/Inspection Charges	1.10%	0.18%	0.92%

Table 4: Cost issues of unexempt and exempt trusts

	Un-exempt	Exempt Trust
Administration of the Fund	EPFO	In-house, hence more control over funds
Service Levels—processing of applications	Unpredictable, no fixed timelines	Better and more reliable service. Immediate on receiving application

Table 5: Comparison of EPFO and Exempt Trusts

Annual. contribution per member	1986	1991	1996	2001
Total	1.36	2.57	3.06	4.08
Exempt Establishments	2.55	4.81	6.67	10.16
Non-exempt Establishments	0.84	1.70	1.96	2.90

From Prof. Mukhul Asher's research based on EPFO Annual Reports

India's fiscal year ends March 31. Therefore 1986 means the year ending March 31, 1986

Table 6: Contribution by exempt and non-exempt establishments

4 COMPARISON OF UN-EXEMPT AND EXEMPT

4.1 Contribution

The average contribution by the employees of Exempt Trusts has always been three times more than that of the average contribution of un-exempt employees. (See Table 6)

This huge difference in contributions per member reflects self-selection by employers; those that form exempt trusts pay above national average wages and are willing to undertake the administrative responsibility and investment risk to provide a higher level of service to their employees.

Contributions to Exempt PF Trusts still constitute a large chunk of total contributions.

Category	2001		2000		1999	
	PF Con-tribution	% to to-tal	PF Con-tribution	% to to-tal	PF Con-tribution	% to to-tal
Unexempt	63.99	59.65	57.78	59.68	49.54	63.55
Exempt	43.29	40.35	39.04	40.32	28.41	36.45
Total	107.28	100.00	96.82	100.00	77.95	100.00

From the Annual Report of Labour Ministry 2000-2001

Year	Un-exempt	Exempt Trusts	Total
1990-91	960.30	1319.80	2280.10
1991-92	942.60	1352.10	2294.70
1992-93	1279.50	1398.20	2677.70
1993-94	1649.00	1960.90	3609.90
1994-95	1913.80	1559.50	3473.30
1995-96	2390.40	1823.60	4214.00
1996-97	3021.00	1644.60	4665.60
1997-98	2861.70	1778.00	4639.70
1998-99	3383.10	2348.70	5731.80
1999-00	5891.70	4691.30	10583.00
2000-01	7665.10	4175.90	11841.00

From the Annual Report of Labour Ministry 2000 2001

Table 7: Provident Fund Arrears (End of Year - INR Million)

4.2 Compliance

There is no clear trend in the compliance records of the un-exempt versus the exempt sector. (See Table 7)

Figures published by the Labor Ministry over the last decade indicate a lower level of compliance by exempt employers.

A few rogue employers have used contributions deducted for exempt trusts for working capital. However, there is no mechanism to ensure this will not happen or reason to believe it is lower in the un-exempt sector. Arrears or poor compliance are caused more by a lack of supervision rather than the absence of a proper regulatory framework. Current regulations require all exempt trusts to submit detailed monthly information to the EPFO, which must include the following information:

- a) The status of the employees and subscribers to the EPF Scheme,
- b) Cumulative contributions, Loans and Advances granted, Balance available
- c) Wages, Current contributions, Inflows and Outflows
- d) Status of portfolio

Location	2001		2000		Change (million)
	Employers (no)	Arrears (million)	Employers (no)	Arrears (million)	
Mumbai	8	17.23	13	29.44	-12.21
Nagpur	3	34.84	2	17.10	17.74
Nasik	1	1.76	1	1.76	0.00
Pune	5	129.01	6	118.57	10.44
Kolhapur	1	0.72	2	0.76	-0.04

From the Annual Report of Labour Ministry 2000-2001

Table 8: Provident Fund Arrears (End of Year - INR Million)

Industry	No. Employers	Arrears (INR Millions)	% Age to total
Textile	8	68.87	37.52
EMGE	2	7.15	3.89
Sugar	1	0.72	0.39
Trading & Commercial	1	2.79	1.52
Others	6	104.01	56.66
TOTAL	18	183.54	100.00

Table 9: Industry Defaults in 2001

4.3 Case Study; Detailed Look at Maharashtra

(From the Annual Report of RPF, Maharashtra for the year 2000-2001)

The State of Maharashtra, which is the most industrialized state in India and with large number of exempt employers, offers the most illustrative sample for the entire population of exempt trusts in the Country. (See Table 8)

Most defaults are skewed by industry fortunes. Details on Maharashtra are in line with the industrial landscape and industry defaults at the end of the financial year 2001 show that the failing textile industry accounts for more than a third of defaults. (See Table 9)

It is clear that the public sector employers are no better at compliance; in fact it is just the opposite as the failing public sector employers account for almost three-quarters of defaults as on the end of the fiscal 2001. (See Table 10)

Industrial sickness is another major contributor. This accounts for 38% of the failure to pay contributions to the exempt trust, which is on par with

Sector	No. of employers	Default amount (INR Millions)	% to total
PSU	8	132.32	72.09
Private	10	51.23	27.91
TOTAL	18	183.55	100.00

Table 10: Public sector defaults as of 2001

Reason for Arrears	No. of employers	Default amount (INR Million)	% to total
Ind. Sickness	12	700.91	38.18
Others	6	1134.61	61.82
Total	18	1835.52	100.00

Table 11: Reasons for Arrears

that of the un-exempt employers.

4.4 Governance Structure

The responsibility of plan trustees is fiduciary and is loosely defined in the *Indian Trust Act, 1882*. The PF Act and the rules prescribe the role and duties of the board of trustees as follows:

- i) Maintain detailed accounts to show the contributions credited, withdrawals made and interest accrued in respect of each employee
- ii) Submit such returns to the Regional Provident Fund Commissioner or any other officer as the Central Government may direct from time to time;
- iii) Invest the Provident Fund monies in accordance with the directions issued by the Central Government from time to time;
- iv) Transfer where necessary the Provident Fund account of any employees
- v) Perform such other duties as may be specified in the Scheme.

Disclosure Norms

- i) The legal requirement is that the Trustees are required to issue the Annual Account Statement to the members within six months of the closure of the accounting year.
- ii) The other legal requirement is to make the audited books of accounts available for inspection by members.

The rules only detail procedural requirements for the appointment of trustees and the minimum number required to be appointed. e.g., there should be an equal number of Trustees representing Employer and Employees and that the Employee Trustees are to be elected by poll every three years.

These rules however do not clearly enumerate the fiduciary role of a Trustee of a Provident Fund Trust, but rather those of administrative responsibilities.

It is common to see that the Employer Trustees are normally the CFO and Head HR of the employer and where as the Employee Trustees are Union Representatives in a unionized situation. With their work pressures the CFO or the Head HR do not really give the required attention to the matters of routine administration and the responsibility is more often than not passed down to the lower functionaries in the Finance or HR departments of the employer.

While the Trustees are required to meet every quarter as per the requirement of the EPFO, these meetings more often than not are recorded for the sake of legal requirements. Only in situations where the employees are well organized and represented by union representatives is the role of trustees is taken seriously.

The normal decisions required to be made by the Trustees are transactions of the trust, which are basically approving various withdrawal requests. The finance functionary almost always handles the important aspect of investment of contributions of the trust and the decisions are formalized in the trustee meetings.

4.5 Process of formation of Exempt Trust

Employers who cross twenty employees and want to form their own exempt trust are forced to go through a cumbersome and tedious process

- Firstly comply as un-exempt and pay all dues to the EPFO
- Set up a Provident Fund Trust
- Apply for and obtain recognition from the Commissioner of Income Tax
- Apply to the Regional Provident Fund Commissioner (RPFC) with
 - Pro-forma of application
 - Details of contractors
 - Consent Signatures of majority of employees
 - Comparison between the trust rules and PF Scheme
- Undergo a formal inspection by the RPFC

- RPFC forwards it's recommendation to CPFC after multiple iterations of queries and clarifications.
- CPFC after its own a due diligence and forwards it's recommendation to the Ministry of Labor or State Government
- The Ministry of Labor or State Government notifies the exemption in the official gazette

4.6 Current Status on the Process of Exemption

The process of exemption has been categorically frozen since 1997. This process of exemption has been and continues to be a highly cumbersome and time consuming, while neither meeting the objectives of employers nor employees. A large number of employers, who applied for exemptions, are waiting indefinitely for clearance to start their own trusts and stop paying to the EPFO. The earlier power of Regional Provident Fund Commissioners to grant relaxations (interim approval to start exempt trusts) has also been withdrawn.

The EPFO says that they are reviewing the entire exemption issue because of abuses by employers. However, the review has not been transparent and seems more like an effort to protect their turf against competition. To counter the threat of defaults by the exempt employer, as a safeguard measure all applications for exemptions are accompanied by a guarantee that the employers are willing to assume the risk of matching the administered interest rate for the sake of their employees. Nevertheless, employers who want exemptions are forced to continue paying into the EPFO with all attendant charges that are substantially higher than the alternatives available.

4.7 Reform Agenda

4.7.1 Independent Regulator; time to end dual and conflicting role of the EPFO

Companies with over twenty employees have to pay 24% of salary to the Employees Provident Fund Organization (EPFO). This monopoly position does not subject charges or service to competition. Further employers pay an additional 4.4% of contributions as asset management and administration fees (probably the highest in the world) with service levels that, mildly put, and could do with improvement.

Nobody disputes the complexities of creating competition in a mandatory contribution pension plan but that cannot be an argument against it. First phase of reform needs to separate the regulatory and administrative roles

of the EPFO and subject the administrative part (which is nothing but an asset management and IT services operation) to open competition.

The immediate implication will be giving free choice to employers in choosing an administrative and / or investment service provider for Provident Fund compliance and scrap the current convoluted and bizarre exemption process.

4.7.2 Exemption Process

Available Options for New Companies

All new companies that cross the threshold of 20 employees are compulsorily required to comply as un-exempt by remitting their contributions to the EPFO. A number of new companies (IT, Multinationals, etc) that have large growth plans would like to provide retirement benefits including Provident Fund by setting up a private trust from day one. However, these companies are forced to comply as un-exempt for their application for exemption to be considered. This involves

- Transfer of all the balances in the private trust to EPFO
- Remittance of Contributions till grant of exemption to be remitted to EPFO
- Transfer of individual accumulations back to the Exempt Trust
- All this exercise involves the EPFO allocating resources for an employer who, in any case, wants an exemption.

Suggestions:

- Companies aspiring for exemption should be obligated to apply for exemption under clearly laid guidelines within 30 days of their meeting any criteria of coverage under the PF Act. In the interim, they need not comply as un-exempt.
- They may be allowed from the date of coverage to continue to remit their PF contributions into their own Provident Fund Trust, provided they apply for exemption along with their coverage application to EPFO. However, they should remit their EPS and EDLI contributions and charges to the respective RPFs.
- This ensures that the resources of EPFO are not wasted on an employer who is capable of administering the Provident Fund for the benefit of his employees.
- To safeguard against these companies folding up and leaving the employees in the lurch, EPFO may insist on a Bank Guarantee for a percentage of salary based on time bound approval of exemptions.

Options for Existing Un-exempt Employer

- Specify clear guidelines (size of employees, base of calculation, profitability, etc) and simple documentation so multiple iterations and interpretations are avoided.
- Re-instating the power of relaxation to RPFCs with a caveat that only if the RPFC is satisfied about the 100% compliance status relaxation could be granted.
- Delegation of power to notify exemption to the CPFCs or even RPFCs
- Prescribing an automatic approval or time-bound approvals for the process, e.g. within 30 days of complete application RPFC to forward the application to CPFC and within 30 days of application reaching CPFC, application to be approved etc.
- Making the decisions on exemption process both at the RPFC and CPFC level appealable to the PF Appellate tribunal. This will give a reasonable opportunity to the employers against arbitrary decisions at RPFC levels.

Restructuring Scenarios

Since the liberalization and globalization of the Indian economy in the early 1990s, the competitive environment for Indian industry has substantially changed. Companies are witnessing a great amount of churning by restructuring through mergers, acquisitions, de-mergers etc.

The current framework of Provident Fund law and its administrative machinery does not provide for such a dynamic environment and this leads to considerable confusion and inefficiencies for employers. The possible scenarios presented by such restructuring are:

- An exempt employer merging with an un-exempt one
- Merger of two exempt establishments
- De-merger of employer with an exempt trust
- Merger of employers located under different RPFC/APFC jurisdictions

Suggestions on Restructuring Scenarios

- Resultant Entity of any type of restructuring shall be allowed to choose the compliance option.
- Restructured Employers to be given time to set up their own PF Exempt Trusts till which time they may be permitted to comply as participants of the Exempt Trusts of parent establishments. Or in the alternative they may be allowed to contribute into their own trusts till they are granted exemption.
- On Merger of two exempt employers, RPFCs may allow the employer to merge the PF Exempt trusts at an administratively convenient location.
- On Merger of exempt and un-exempt establishments, RPFCs may allow participation of un-exempt employees to the exempt trusts.

- On Merger of un-exempt establishments, the merged establishment may be allowed to comply from single administratively convenient location for all the merged established.

4.8 Scrap the Employee Pension Scheme

Not many people with a Provident Fund account know that 8.33% of their salary is sent to a badly designed Employees Pension Scheme (EPS) that does not come back as a lump sum. The scheme was introduced with no debate, employers opposed it, employees do not like it, the Supreme Court has heard several arguments, but the Employees Provident Fund Organization (EPFO) just will not back down.

The details of the Employee Pension Scheme are heavy; however, the mother nature design flaw of fixed benefits and contributions is probably unfixable. Other issues include a defined benefit plan with individual balances, early withdrawals that destroy pooling effects, opening balances that may not cover past service liability, a committed central government subsidy, etc.

Most importantly, the EPS is actuarially unsound and probably unsustainable; an asset shortfall will require a government bail-out (ala UTI, Indian Bank, et al) sometime in the next ten years. It is nothing but a contingent liability on Government Finances that will surely be called on.

Key arguments against EPS reform are that choices are limited and operational unwinding will be too complicated. An elegant operational and structural solution to unwind EPS would be returning the past and future 8.33% to where it came; the defined contribution account of individual subscribers.

4.9 Portability

The Provident Fund Commissioner currently prohibits the free transfer of accumulations between exempt trusts and excluded trusts (set up by employers for employees not covered by the PF Act and participants with base salary above INR 6500/-). This prohibition completely defeats the intent of portability and it appears it is driven by the EPFO trying to stifle the growth of schemes outside their purview and this should be allowed immediately. Portability from one employment to another within EPFO is administratively complex and time consuming forcing the members to withdraw at every change of employment. This is one of the primary reasons for small PF accumulations at retirement.

4.10 Tax Issues

The Income Tax Act needs to attack the two issues immediately. First being the taxing of investment returns beyond the rate credited by the EPFO. This removes all incentives for prudent fund management. Very few exempt trusts currently pass on the benefit of higher corpus returns to members since any credit higher than the PF commissioner attracts tax and mandates complicated Tax Deduction at Source procedures. This creates a large reserve account in some well-managed funds. The distribution of this reserve at some point in the future will create unfair cross-subsidies for the current members at the time of distribution. Employees who leave early lose their share of the created reserves.

Secondly, parity between Exempt Trusts and EPFO needs to be introduced with respect to taxing the withdrawal of PF accumulations. All exempt trusts currently deduct Tax at Source for lump sum withdrawals before five years of service. The EPFO currently does not follow this practice. It is important to level the playing field by removing this anomaly. This would also discourage withdrawals at every change of job.

4.11 Early Access to Accumulation

Liberal early withdrawal options from the Provident Fund account have led to the average terminal accumulation value being only around INR 25,000. A number of leakages (Retirement, Medical Care, Housing, Family obligation, Education of Children, Financing of Insurance Policies, etc) need to be plugged but this may not be possible given the high rates of contribution.

Any plugging of leakages should be accompanied by a reduction in the rates of contribution from 24% to somewhere in the range of seventeen or eighteen percent. In addition ensuring portability and tax on early withdrawals would definitely help in increasing the accumulation at retirement.

Table (12) shows the categories of withdrawals

With the exempt trusts providing better and more accessible service than the EPFO, members of exempt trusts have faster and easier access to the corpus. The state of Maharashtra is an interesting example of the difference in un-exempt and exempt withdrawals. (See Table 13)

Category		Number (000s)	% of Total	Amount(mil- lion)	% of Total
Total	With-	394.0	100.0	7819.5	100.0
drawals					
Life	Insurance	14.3	3.6	112.3	1.4
Policies					
Housing		62.8	15.9	3344.6	42.8
Closure of Estab-		56.7	14.4	804.1	10.3
lishment					
Health Care		68.7	17.4	1006.5	12.9
Marriage and Ed-		171.5	43.5	2251.8	28.8
ucation					
Others		20.0	5.1	300.3	3.8

Source: Prof. Mukul Asher's research. Calculated from Government of India, Ministry of Labour, EPFO, Annual Report 1999-2000 (Tables 6 & 23)

Table 12: PF: Pre-Retirement Withdrawals, 1999-2000

Category	Exempt Trusts		By the PF Commissioner	
	Case (nos)	Amount (INR millions)	Case (nos)	Amount (INR millions)
Financing Policy	LIC 1320	7.63	271	16.46
Housing	Ad- 24323	1698.75	19700	1295.60
During tempo- rary closure	0	0	10756	297.96
Illness	11561	210.13	5307	131.41
Marriage	11665	400.01	16349	402.44
90% withdrawal	219	65.85	0	0.00
Others	6098	293.21	753	93.22
Total	55186	2675.57	53136	2237.09

Source: Annual Report 2000-01 of Regional Provident Fund Commissioner, Maharashtra

Table 13: Advances Sanctioned and Amount disbursed in 2000-01

4.12 Operational and Infrastructure Issues

e Filing for compliance of exempt trusts

Technology is knocking on the doors of the EPFO. It is high time the independent regulator or EPFO provides for the filing of returns via the Internet. An employer with a distinctive identification number and password should be able to access the database to file his monthly and yearly returns over the Internet. The IT infrastructure should also be able generate automated acknowledgements in proof of filing of returns.

Other benefits would be enabling the employer to submit applications on behalf of its employees for various transactions such as settlements/loans etc. The employer will also be able to file the nomination and other details of his employees through electronic media thereby reducing tedious time-consuming paper work.

e Transactions by exempt trusts

With the Information Technology Act recognizing electronic documents, it would be very effective to allow exempt trusts to operate based on documents transmitted electronically. Despite a well-developed Information Technology infrastructure available with an exempted employer, exempt trusts currently are forced to maintain all their back up papers in hard copy. These include nomination and declaration papers, loan applications, and settlement applications. In the absence of hard copy of documents, currently EPFO inspectors dispute the veracity of many a transactions of the trust and create issues during their physical inspections. If exempt trusts were allowed to operate with electronic documents, the following benefits would accrue

- Facilitate smoother and better administration of trusts.
- Increase accountability towards the members.
- Enhance service quality and access to information for members.
- Transaction processing would be made easier, leading to higher employee satisfaction.

5 SUPERANNUATION AND GRATUITY FUNDS

5.1 Status of the Market

Gratuity is a benefit mandated under the **Payment of Gratuity Act, 1972** (The Gratuity Act) and the employer is under a statutory obligation to pay gratuity to his employees under the stipulated conditions. However the benefit is largely unregulated except for the provisions in the Income

Tax Act, 1961 (the IT Act) if the employer had set up an Gratuity Fund approved by Income Tax Authorities.

The Gratuity Act is currently enforced by the Labor Commissioners of the respective state governments. This leads to differential regulations. As per the Section 4A of the Gratuity Act, each State can notify the clauses for exemption from an insurance policy in their own way.

Gratuity is a retirement benefit and needs to be administered differently than other Labor legislations like the Factories Act, Payment of Wages Act etc.

Superannuation is a Voluntary Occupational Pension Scheme adopted by employers. There is no legislation of regulatory body for these plans other than the Income Tax Department.

The employers who wanted to fund and institutionalize either the Gratuity or Superannuation scheme had two options. One was to approach the Life Insurance Corporation of India (LIC), the state life insurance monopoly until the other day, for a group insurance product and the second alternative was to administer a trust with employee and employer trustees. While employer run pension schemes can accumulate and invest funds, they are required to purchase annuities on behalf of the retiring employees from LIC.

As of March 1998, the total accumulated fund for these group pension plans was about INR 65 Billion, of which the LIC managed INR 49.7 Billion on behalf of 4719 Schemes.¹

5.2 Shift in Superannuation: Defined Benefit (DB) to Defined Contribution (DC)

Most early superannuation plans were Defined Benefit (DB) plans as occupational pensions in India have their roots as a reward for the long service. The base assumptions for the DB Scheme are no longer valid in India. Further the following reasons have contributed to the employers switching from DB

- Continuity of employee profile and company growth
- Young employees subsidizing the old
- Salary Restructuring:
 - Pensions / Contributions are a part of the employee's compensation
 - Non-linear salary growth; shift from reimbursements to taxable components

¹See IMF Working Paper WP/01/125/ - Pension Reforms in India by Robert Gillingham and Daniel Kanda

- Portability preferences: no concept of lifetime employment. Long service with a single employer is no longer considered a virtue
- Corporate Restructuring: constant and continuous changes in the Structure of Institutions / Industries due to mergers and acquisitions
- Tax regime which limits the tax deductibility of contributions to the employer to a fixed percentage of salary

DB To DC: CFO Perspective:

From the CFO's perspective the biggest advantage is that the Company's liability will be crystallized and the fund will always be fully funded by definition. The investment risk gets shifted to the employee and a DC scheme will no longer be susceptible to design abuse. Other advantages from the CFO's viewpoints are:

- Vulnerability to rapid change in assumptions of interest rate, salary escalation etc
- Uniform contribution for all employees
- Portable Benefit that can be calculated in Cost to Company
- Most companies in any case contribute 15% of salary irrespective of actuarial valuation and the switch does not affect the cost to the company.
- Annual actuarial valuation not necessary.

DB to DC: HR Perspective:

For the HR function, the biggest advantage a DC scheme is that it is easily understood by an employee. The benefits are transparent and could be quantified at any point of time. It also offers the advantage of portability. Besides

- Benefits under DB depend upon the solvency of the fund but DC is always fully funded by definition
- DB is a pooled fund and members do not always get proportionate benefit of Company's contribution of 15% of salary.
- No cross subsidy between members and no anomaly of benefits
- Under DC, all contributions are made to the individual's accounts with an opening balance from the pooled fund
- Member gets direct benefit of higher yield
- Members will be aware of the amount to his/ her credit on a given date
- Benefit is easily portable in case of resignation / transfer
- Vesting conditions will be less stringent
- Employee Contribution is also possible

Critical Variables / Decisions in Shift

There are a few critical variables which play an important role in the shift. The Solvency of fund, more often than not aggressive actuarial assumptions in the earlier assumptions would have led to poor funding. The population of employees who have already been vested with substantial benefits by virtue of their long service and their openness to the idea of shift is also crucial.

The ability of the employer to make additional contributions and the extent to which he will be able to get the tax deduction would also contribute to the decision to shift from DB to DC. Employer also needs to take other crucial decisions as to method of opening balance allocation, new vesting and eligibility conditions.

Process of Shift

Analyzing the existing Benefits Plan Understanding employer specific compensation mechanism and Benefits Philosophy is the first step in the process. Followed by a detailed analysis on the pension option provided by the current scheme such as vesting conditions, eligibility conditions, pension options available, transfer in and out etc;

Market comparison The next step after the study and understanding phase is the comparison of the current scheme to the other schemes. It is also important to study the global and market changes peculiar to the specific industry, which might have an impact on the Pension area.

Philosophy Changes Next phase is informing employer about modifications that is required in the philosophy and the options available for modifying the scheme benefits. The impact on different groups of employees on each of the options of shift also to be studied and communicated.

Designing a new DC scheme Once the employer consent is obtained on the modifications and options, the new DC Scheme is designed with the following:

- Articulation of plan objectives
- Actuarial Valuations
- Initial design indicating alignment with the modified philosophy
- Options evaluation balancing the financial liability and employee benefits
- Calculation of employee benefits under the old and new plan
- Determining contributions required for the institution to fund the pension amount.
- Once the new scheme is designed the next phase is the employee communication explaining the difference of pension benefits available before and after transition and the cost
- Benefit analysis and determining liability for the Institution

5.3 Reform Agenda

5.3.1 Mandate Asset Segregation/Funding

Background

The Gratuity Act while mandating gratuity as a benefit and defining eligibility norms, quantum of benefit etc, is silent on how the employer should fund the liability. The Act leaves the aspects of funding, to the discretion of the employer. However from a corporate governance perspective, the Accounting Standards prescribed by Institute of Chartered Accountants of India requires the employer to value the liability actuarially and provide for the same in the books.

The Gratuity Act provides for compulsory insurance for the liability under the Act (Section 4A) and also for exemption from the requirement for compulsory insurance if the employer has set up an Income Tax approved Gratuity Fund. However the provision has not been made effective, as State Governments have not notified this provision.

There is no incentive for employers to fund gratuity liability, either through an insurance policy or by setting up an IT approved Gratuity Fund. In the event of unexpected closure of a business, employer would not be able to meet the gratuity liability.

The Section 4A of the Gratuity Act, seeking to make it mandatory for funding gratuity liability shall be notified with immediate effect.

The obvious advantage of mandatory funding of gratuity liability is that the liability is always funded and the employee is assured of receipt of gratuity at the time of termination of employment. It should be clearly laid out that the employer should either obtain an insurance policy or set up a gratuity fund with the due approval of Income Tax authorities. Actuarial valuation of Gratuity Liability should be made compulsory for all the employers in the Gratuity Act itself. Further, it should also be made mandatory that the contribution/premium is paid annually within a specified time limit. Such Contributions/Premium shall be made an eligible expenditure in the year of contribution.

5.3.2 Review Tax Deductibility Cap on DB Contribution

Background

The Income Tax rules cap the business deduction on contribution to Superannuation and Gratuity arbitrarily at 15% (including Provident Fund contribution of 12% shall not exceed 27%) of the Basic Salary and 8.33%

of the Basic Salary respectively per annum. While Defined Contribution Superannuation could be restricted to 15% of the gross basic salary, the Defined Benefit Contributions shall be allowed subject to an actuarial valuation. The contributions, which are arrived at based on actuarial valuation, shall be allowed as deductions. The current cap on the contributions could lead to asset liability mismatch if the employer decides to restrict the contributions to the cap. In respect of the initial contribution, it is allowed as a deduction over a period of five years.

Possible advantages of removing the cap on the business deduction on contribution

- The Trusts would be fully funded as it would require employers to fully contribute based on the actuarial valuation
- It will encourage the employers to set up such trusts for the benefit of their employees

Suggestions

- The cap on the business deduction on the contributions to trusts shall be removed if it is based on the actuarial valuation
- To avoid excessive contributions, there could be a cap on the defined benefit, for example, the gratuity benefit could be limited to the benefit defined under the Gratuity Act
- Allow full deduction in the year of contribution itself

5.3.3 Framework for Actuarial Services

Actuaries who provide valuation services to Defined Benefit Plans (Superannuation, Gratuity, Leave encashment) are not governed by any regulations apart from the Actuarial Society of India's, professional conduct rules. The individual actuary and the trustees jointly decide the actuarial assumptions for various valuations. Aggressive actuarial assumptions have led to under funding in many such plans. One reason for the situation is non-availability of compiled data on assumptions such as industry wide salary escalations, turnover rates etc.

The Actuarial Society of India or the future governing body of the actuarial profession should evolve standards for actuarial assumptions that leave enough discretion for the actuary to meet specific realities of different situations (trusts, employers, industries, etc)

Investment	By Ministry of Finance (%)	By the Trust as on 30.11.1999 (%)	By the Trust as on 31.07.2000 (%)
(i) Central Government Securities	25	13.7	19.0
(ii) State Government Securities	15	15.2	17.2
(iii) Bonds or Securities of Public Financial Institutions, Public Sector Companies and IDFC	40	32.3	29.6
(iv) To be invested in any of the above three categories as decided by the trustees.	20	38.71*	34.32*

*Invested in "special deposit scheme".

Table 14: Investment patterns: Mandated vs. Actual

5.4 Create Regulatory Framework

Superannuation and Gratuity Plans today practically operate under no comprehensive regulatory framework or regulator. The only touch point is the Income Tax Act. However, Income Tax authorities have a specific agenda and often only demand reports from an information perspective. It is important to integrate the regulatory framework for these funds with the bigger picture of occupational pensions.

6 INVESTMENTS

6.1 Background

The Finance Ministry currently mandates the investment pattern for PF trusts with three possible objectives a) Safety, b) Captive demand for government paper, and c) Ability to influence interest rates.

Table14 shows the mandated patterns versus actual investments of a typical retiral trust and highlights the huge portion of Special Deposit (non-securitized government deposit):

The evolution of the pattern of investment has been slow. The essential shift has been from direct investments in the Government to investments in Government enterprises.

The trustees take the investment decision for these PF Trusts. In most cases, the decision involves a monthly meeting of trustees, followed by a decision to invest the money. Trustees retain discretion on choice of securities and duration of assets within the prescribed asset allocation model.

Regulation does not stipulate the sources of assets. Trustees themselves decide on the choice of secondary/primary markets. Typically, provident funds have been seen to buy bonds from primary sources. Regulation does not permit active management. Sale of securities has to be effected after approval from the PF Commissioner. Currently assets are not marked to market, this needs to change. Regulation does not also permit the trust to pay asset management/consulting/custodian fees.

6.2 Evolution of Mandated Investment Pattern

The pattern of investments is being continually liberalized since the 1970s but progress has been slow. Table 15 indicates changes over time

6.3 Case Study of Exempt Provident Fund

The following example details the experience of a PF Exempt trust that has been in existence since the early 1950s. The trust has a corpus of INR 460 million and the investment performance is shown in Table 16

The portfolio composition over the last four years. The fund is saddled with SDS, which is gradually reducing in proportion to the total corpus.
Highlights

- Returns on assets have fallen by 200 bps.
- This has been on account of falling yields of assets.
- Composition of portfolio has changed to reflect credit quality concerns
- Decline in exposure to Govt. guaranteed debt.
- Increased exposure to AAA assets.
- Sovereign debt exposure – known to be zero risk has declined.

6.4 Investment Issues of Pension Trusts

The current asset allocation model no longer meets the objectives of providing the trustees avenues to invest in safe assets whilst ensuring a reasonable rate of return.

Investment Categories	Cate-	Pre 1975	1975-85	1985-92	1993-94	1994-95	1995-96	1996-97	1997-98	1998	Now
S.D.S.		-	30	Not more than 85	70	55	30	20	-	-	-
G.O.I./Mutual funds@		100	70	Not Less than 15	15	15	25	25	25	25	25
S.D.L/ Guaranteed Securities/Mutual funds	State Se-	100	70	Not Less than 15	15	15	15	15	15		
P.S.U./ Bonds/Certificate of Deposit	DFI	-	-	-	15	30	30	40	40	40	40
Any of the above		-	-	-	-	-	-	-	20	20	20
Pvt. Sector		-	-	-	-	-	-	-	-	10*	10*
Total		100	100	100	100	100	100	100	100	100	100

*10% represents 20%-10% = 10% and not 10% of 20% = 2%, this is as per clarification issued by RPF, Maharashtra and Goa. @ mutual funds refer to dedicated gilt funds, introduced in april '99

* Interest proceed from any category have to be re-invested in the same category

**maturity proceeds may be invested in any category.

Source: Website Investmartindia.com

Table 15: Changes in the Provident Funds Investment pattern (1975-2000) (in %)

	1999	2000	2001	2002
Return	12.69%	12.68%	11.48%	10.70%

Table 16: Case study of an Exempt Provident Fund

Credit worthiness of mandated assets Cases of defaults and delays in debt servicing are on the increase among Government Paper. The deterioration of State Government financial health has further accentuated the credit quality problems. Due to the absence of marking assets to market, the investment of Provident Fund Trusts in default grade assets is largely hidden.

Multiple regulators - Ministry of Labor v. Ministry of Finance The PF Commissioner (Ministry of Labor) mandates the rate of interest payable by provident funds to employees, while the Ministry of Finance sets the rates on the special deposit scheme. A disconnect between the two has led to uncertainty in interest liability and sub-optimal investment decisions. Wide differences exist in the asset allocation models of the Ministry of Finance and Ministry of Labor, e.g., gilt mutual funds form part of the Ministry of Finance's pattern of investment but this is not the case for the Ministry of Labor.

Financial reforms have outpaced pension reforms Changes in financial sector have not been accompanied by changes in the asset allocation for provident funds. Interest rates on savings instruments like the small savings are linked to market rates. Yet, the administered Provident Fund rates remain on the higher side and are not determined by the underlying rates on assets or performance of mandated investment portfolio. Since investment risk is borne by the company there is an inherent inability to establish and implement risk management practices. In addition, the inability to sell assets without approval from the EPFO forces the trustees away from implementing practices to manage credit and interest rate risk. Therefore trustees being typically executives of the employer tend to be 'yield chasers', disregarding the risks involved

The current regulation does not permit trusts to pay custodian and portfolio advisory fees. These have to be picked up by the company. Trustees, therefore tend to refrain from using services of such professional advisors.

Operational The PF Trusts' access to live prices and AAA rated assets are restricted as such assets are rarely trade in retail lots. Market lots (interbank 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 50 million. 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 broking firms who pose settlement risk.

Declining yields Lower interest rates on Sovereign bonds and AAA Bonds coupled with sticky interest rates on liabilities has resulted in provident funds finding it difficult to meet the mandated rates of return.

6.5 Reform Agenda

6.5.1 Asset Administration

Trusts should be permitted to pay asset management / custodian fees. Complexities in investing have necessitated the need for fund managers, investment advisors and custodians. The current rule of employer picking up the tab is a major disincentive to the trustee to avail the services of professionals.

Trusts should be forced to evolve and implement risk management practices such as

- Asset Holding practices
 - It should be mandatory for all applicable public sector / financial institution bonds to be held in electronic form.
 - It should be mandatory for all state and central Government securities to be held in a Constituent SGL.
 - It should be mandatory for all physical securities to be held by a SEBI recognized custodian.
- Counter party risk management practices
 - Counter party norms should be valid for all Non Delivery vs. Payment Transaction
 - Counter party net worth to be a minimum of Rs.100 crores.
 - Counter party to be regulated by the Reserve Bank of India.
- Settlement risk management practice
 - All non Government Security transactions to be in electronic form
 - All Government Security transactions to be in Securities General Ledger
- Credit exposure norms
 - Caps on exposure to sectors and institutions should be defined and implemented.
- All assets of trusts should be marked to market.

6.6 Asset Allocation

Employer choice should precede employee choice

It is important that employer choice precedes employee choice in investment decisions rather than jump to the 401k structure of the United States.

The move to employee driven investments will have to be preceded by greater investor understanding of the nature of investments and the risks associated with them. Retail investors have very often-turned yield chasers and burnt all five fingers with no understanding of the risk / return trade-off.

Broaden Asset Choices in Mandated Pattern

We hold the conservative view that while equity markets in India may be ready for pension money, pension money in India is not ready for equity markets. Financial sophistication is still evolving and Indian equity markets aren't yet ready on issues like disclosure, governance, and there is no vibrant market for corporate control. Even when equities are allowed, indexed investments should precede active direct equity investments.

It is important to sequence changes in asset allocation and we feel compromise incremental reform will be more effective than radical reform.

Possible Roadmap

- Phase I
 - Liberalize the asset allocation model
 - * Amend regulations to dictate the assets permissible. Limits to be set by trustees as per portfolio plan
 - * Permit Trusts to invest in
 - Corporate debt mutual funds.
 - Liquid mutual funds.
 - Index based mutual funds (facilitate limited equity exposure).
 - Deposits of banks.
 - * Increasing the permissible investible surplus in mutual funds will enable trusts reap the benefits of
 - Mutualisation.
 - Active management of assets.
 - Increased focus and utilization of professionals in investments.
 - * The Trustees should disclose to the member a portfolio plan detailing
 - The investment philosophy
 - The risk management practices.
 - * Investment choice should be entirely with the Employer
 - * Mandated rate of return to be retained. This should however be a floating rate.
 - * Increase Trustee fiduciary responsibility.
- Phase II
 - Retain the asset allocation model.
 - * Government Debt.
 - * PSU Debt.
 - * Gilt / Corporate debt / Liquid / Index based mutual fund.
 - * Deposits of banks.
 - Limited employee choice to be introduced

- * Employee can choose to go with the trustees' decision or invest as per his choice.
- * Employee choice to be restricted.
- * Trustees to facilitate this by appointing a panel of investment advisors with adequate track record.
- Unitize the corpus. This will remove guaranteed return and will prepare ground of larger employee participation.
- Phase III
 - Introduce equity exposure. Permitted assets to include
 - * Government Debt.
 - * Public Sector Undertaking (PSU) Debt.
 - * Gilt / Corporate debt / Liquid / Index based mutual fund.
 - * Deposits of banks.
 - * Equity.
 - Returns not to be mandated
 - Investment decision to be either employee or employer at the discretion of the employee.

6.6.1 Asset Management

- Link provident fund interest rates to market rates
 - Interest rates on provident fund should be related to market rates of interest. The rate can be at a spread over the benchmark risk free rates of return. This would be ideal given the asset allocation model of these trusts.
 - The rate should be reset with a bi annual frequency to reflect changes in rates in the benchmark. This will ensure that rates on provident funds are not sticky.
- Permit sale of securities without permission from the provident fund commissioner to facilitate: Asset – liability matching, Liquidity management and Credit risk management. Active management of the funds will also help increase returns – an effective hedge in a declining interest rate regime.
- Securitize / Impart liquidity to Special Deposit Scheme. Most pension funds today have invested in the Special Deposit Scheme and it is a drag on the earnings of the trust on account of its illiquidity. Liquidity can be imparted to the Special Deposit Scheme by Phased conversion of SDS into dated Government Securities and permission to transfer / trade on SDS among trusts at pre decided prices.

7 INDUSTRY ISSUES

7.1 Integrated Regulatory Bodies and Framework

An Integrated Pension Regulator (IRDA, SEBI, or restructured EPFO) needs to be identified as the first step. This would put an end to the dual and conflicting role of EPFO as both administrator and regulator

The currently Gratuity is regulated by the state level Labor Commissioners with the individual states given powers to regulate the gratuity. Similarly, Superannuation is regulated only from Income Tax perspective with no regulation on how the benefits are administered, governance norms.

The Integrated Regulator would then be solely responsible for all legislation and supervision of players in the industry (investment managers, insurers, and administrators). The Superannuation Trusts set up by employer, though voluntarily, will get regulated and the employee benefits as assured by the Employer at the time of commencement of employment would get the same at the time of retirement. Also, the Income Tax Act provisions could be aligned with the requirements of the Pension Regulator rather than having to get all the state wise regulations in line.

7.2 Fiduciary Responsibility of Plan trustees / Governance

Plan trustees currently have no liability for plan performance or actions. The highest leverage in any reform program would be creation of fiduciary and criminal liability for plan trustees as individuals. The current lack of a framework has created at times an incestuous relationship between trustees and financial intermediaries that lead to decisions that are not always taken in the interests of, plan participants. This role needs to be clarified and the downside needs to be amplified. Trustees of the exempt trusts are not monitored effectively. Though the trustees are required to file monthly returns (in the form Annexure A which captures all the required details except the transaction processing details) for PF these are not regularly scrutinized. Superannuation and Gratuity trusts have to file no monthly returns.

Suggestion:

- Current structure is over-regulated but under-supervised; a flip over is required
- Monthly Scrutiny of returns and follow ups
- Create a fiduciary framework for trustees that will hold them accountable and create criminal downsides.

- Yearly inspections to be turned into yearly trustee meetings with a nominee from the Pension Regulator (preferably a neutral independent professional from a panel of Chartered Accountants or Company Secretaries) attending the same.
- Such independent nominee to report the yearly status to Pension Regulator and recommend corrective action if any.

7.3 Creation of Licensed Pension Administrators (LPAs)

Exempt trusts and other pension trusts are currently managed by employer and employee trustees. More often than not the CFO and HR Head, are required to administer the trusts. The day-to-day administration is further delegated to the Finance Department of the employer and does not get the attention it deserves except probably for investment of the corpus and settlements/loan disbursement. A number of employers are opting for outsourcing arrangements to take care of administrative activities

Licensed Pension Administrators (LPAs) Outsourcing is still not recognized by the EPFO, but a formalization of the pension administration / outsourcing industry into a regulated and monitored industry would have many upsides. The integrated regulatory body could license institutions that would be authorized to offer pension administration service. The service operation of EPFO could be the first licensee. LPAs would catalyze an industry structure for unbundled and transparent pricing

Role of LPAs

- Compliance
 - Regulatory reporting requirements for each exempt trusts
 - Interfacing between the regulatory body, employers and employees
 - Ensuring the separation of employer and the trustees
 - Limiting the employer's role to making contributions
 - Ensure that all employees are treated uniformly by the trust
 - Employer complies with all the statutory responsibilities
- Benefits Administration
 - Service Level agreements for Settlements, Loan disbursements,
 - Transfers to other trusts / administrators etc
 - Responsibility for all trust accounts, individual statements, all record keeping and audit of accounts

Regulatory Framework

All LPAs shall satisfy certain basic minimum criteria before being allowed to operate, which could include:

- a) Minimum Capital, which could be an entry level and then may be linked to corpus size being managed
- b) IT Infrastructure, a set of minimum Information Technology infrastructure requirements for efficient service delivery. IT infrastructure is a basic requirement to ensure timely transaction processing and employee servicing
- c) All LPAs that would like to offer investment services would be required to secure a Portfolio Management License from SEBI

7.4 Creation of Licensed Pension Managers (LPMs)

All occupational pensions (exempt or excluded PF trusts, superannuation or gratuity) have to invest in a highly regulated investment pattern. Given the traditional lack of volatility and lack of flexibility, most trusts are managed by a low level decision maker of the employer. The inability of the fund to pay asset management fees has resulted in a situation where employers do not seek professional asset management advice but rely on brokers.

Licensed Pension Managers (LPMs) Formally recognize the role of Investment Managers in Pension Funds in two distinct categories, on Portfolio Management and the other mutualised solution.

The base criteria for managers who undertake segregated funds with separate custody should be the Portfolio Management License of SEBI and for managers who want to offer a mutualized solution should be an asset management license of SEBI

Role of LPMs

- Investment Management
- Professional Advice to trustees on asset allocation, risk, asset/ liability management, etc
- Investment housekeeping
- Compliance with mandated investment pattern
- Interfacing with Administrators, Custodians, etc

Regulatory Framework

The pay-in phase could be regulated as asset management and the pay-out phase could be regulated as insurance. However, the ideal situation would be to have a composite and integrated pension regulator responsible for everything.

Criteria for Investment offering by LPMs

All LPMs who would like to offer investment services would be required to obtain a Portfolio Management License from the Securities and Exchange

Board of India (SEBI). SEBI has laid down guidelines of net worth, experience, infrastructure, etc and these are appropriate safeguards to ensure that the choice of LPAs who offer this service are subject to scrutiny and verified for capability and professionalism.

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