A New Framework for Regulation of Pension and Provident Funds in India

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1 Introduction

Providing for income security of the aged populations is an issue that has engaged the attention of all governments. Countries have put in place different institutional structures towards this objective. The World Bank research suggests that countries should design a three-pillar system to provide for income security of people in their old age.

India does not have a public pillar in the nature of social security programmes of the United States or other OECD countries. India though does have a mandatory second pillar by way of occupational plans implemented in the form of mandatory provident and pension funds. These are funded plans but largely publicly managed though there is an option to the employers to set up exempted trusts. Also, taking into account the size of the total population, their coverage is limited. The Third Pillar consisting of voluntary savings and the enjoinment of families to care for their aged as part of the tapestry of traditional Indian culture are the main sources of old age income security in India.

2 Redesign of the Second Pillar

This paper concerns itself with the design (or redesign) of the second pillar in India. It reviews the present structure, particularly the regulatory framework, governing provident and pension funds in India.

It attempts to present a new institutional structure and regulatory framework for pension and provident funds in India aimed at:

- Promoting vibrant growth of the retirement funds industry
- Making pension and provident funds a more effective instrument for old age income security and achieve a higher coverage
- Providing a better benefit structure with lower contributions
- Instituting a strong regulatory oversight for all retirement funds
- Contributing to the economic growth and development of financial markets of the country.

It aims to suggest a road map to graduate from the present tightly controlled regime to a more liberal system operating in freer markets.

3 The Challenge of Pension reform in India

The real challenge in India, lies in extending coverage of old age income security to the unorganized sector, agricultural workers, temporary and ca-

Category	Number in million	% to total
Cultivators	107.1	38.4%
Agricultural labourers	73.8	26.4%
Livestock, forestry, fishing, plantations and allied activities	5.3	1.9%
Mining and quarrying	1.7	0.6%
Manufacturing, processing, servicing etc	28.4	10.2%
Construction	5.4	3.7%
Trade and commerce	20.8	7.5%
Transport, storage and communications	7.8	2.8%
Other services	28.5	10.2%
Total	278.9	100.0%

Table 1: Composition of workers as per 1981 Census

sual workers and self-employed persons. Considering the composition of labor force in the country, coverage cannot substantially be increased without including such categories. In that sense, India presents some unique problems, which need unique and innovative solutions in designing an institutional structure for old age income security.

3.1 Preponderance of Self Employed and Casual Workers

3.6% of the labor force in the country is self-employed, while another 31.2% is engaged in casual wage employment. A large proportion of casual wage workers are agricultural workers. Besides, there is a large segment of casual wage workers who are employed in manufacturing, commercial and service establishments who are not covered by provident and pension fund schemes. Any schemes designed for such workers would need to assume the variability in income that would be normal with such employment. There may even be need for withdrawals in periods of unemployment or low income. Besides, a very different delivery mechanism would need to be designed since there would be no regular employer on whom enforcement responsibility can be fixed as in the case of occupational schemes.

3.2 Composition of the work force

The composition of main workers as per the 1991 census is as shown in Table 1

The work force composition shows the large proportion of the population dependent upon agriculture, both cultivators (who are self-employed) and agricultural workers (who are casual wage workers). With 66.7% of the work force being employed in agriculture and related activities, no substantial increase in coverage can be achieved without covering agriculture.

3.3 Illiteracy and preponderance of the rural aged

73% of the 60+ population in India was illiterate in 1991. 21.9% of the aged were resident in urban areas while 78.1% were resident in rural areas. The aged also constituted a smaller proportion of the urban population at 5.7% as compared to 7.1% of the rural population. The level of literacy and the preponderance of the rural aged suggest the importance of the second pillar in India. Management of voluntary savings (as part of the third pillar) is not easy for illiterate people and for those in the rural areas due to lack of reach of the financial markets. Bank and post office deposits are the only viable savings vehicles that have reach in rural areas. A second pillar which collects savings, either mandatorily or voluntarily, and invests them in relatively higher yielding government, institutional and corporate bonds (as the provident and pension funds do in India at present), managed by professionals, and paying annuities can contribute to better security of the aged.

3.4 Problems of aged and widowed women

Aged women, especially widowed women, pose special problems in design of pension systems. In developed countries, elderly women greatly outnumber elderly men due to higher mortality rates among males and longer life expectancy of females. The problem is not as acute in India. The female sex ratio among the elderly in 1991 was 932 and was only slightly higher than the total population sex ratio of 929. The incidence of widowhood is much higher among the female aged than among the males, as is the trend the world over. In 1991, while only 15% of the males were widowed, as much as 54% of the females were widowed.

3.5 Workers among the aged

Where a society is able to provide opportunities to the aged to earn by engaging in gainful employment suited to them, the burden on the old age security system would be lower. In India, 60% of the males aged over 60 were main workers whereas only 11% of the females were main workers in 1991. The 1991 data also shows that out of the main workers in the 60+

age group, 78% of the males and 84% of the females are in the agriculture sector. Activities like manufacturing and service including professional and technical jobs accounted for 20% of the male and 12% of the female elderly. Though the data shows that a high proportion of the aged are workers, considering that most of them are engaged in agriculture, there is likely to be substantial disguised unemployment.
The above are indicators of some of the complexities involved in designing a second pillar for income security in India.

4 The role of the State

Considering the difficulties involved in designing a second pillar for categories of people such as those outlined above, a legitimate question is whether the state should take responsibility for creating savings in the hands of people for providing for old age income security. The answers are the same, whether for salaried workers covered under occupational plans or for the self-employed or casual workers.

While private savings would certainly be a third pillar of old age income security, it is useful to have a second pillar which forces a person to save during his working life to provide for his old age.

Forced savings would ensure that a person saves an amount at least adequate to meet his basic needs during old age so that he does not become dependent or a parasite on the society at large. Not all people may be prudent enough to plan for their future needs and save during working lives. In any case, the second pillar is expected to take care of only the basic needs rather than all needs of a person during old age.

People may not be in a position to manage voluntary savings well, especially in a country where the literacy levels are low, financial markets are not fully developed and a large majority of the population lives in rural areas. A system that taps savings that would be managed by professionals independent of the saver aiming to provide some basic security during old age would contribute to reducing penury during old age.

There could be several benefits to a country's economy as well. Institutional structures such as those that would form part of the second pillar have the potential to increase savings in the country and lead to development of financial markets. The contribution of contractual savings of the nature created by the second pillar to promotion of robust economic development of a country is well researched.

The State, therefore, needs to establish institutional and legal structures covering as large a proportion of the population as possible that enable people to save a minimum amount for their old age.

5 Need for a new framework

The present institutional and legal structure has achieved substantial coverage among the regular salaried class. A new paradigm is, however, needed to go further. The New Framework needs to have in-built forces that constantly work towards the goal of increasing effective coverage. The pension and provident funds industry in India is state-controlled. The government frames the schemes; a government institution manages more than half of the corpus. The exempted funds are fragmented and, in any case, have little freedom.

The forces of competition need to be unleashed

- To innovate product design and delivery so that coverage can be expanded among unconventional segments of population
- To constantly search for new markets and expand coverage through effective and aggressive marketing
- To focus on better investment management to provide higher benefits with lower contributions
- To provide better service by leveraging technology and introducing contemporary standards in customer service

The competitive system and regulatory structure needs to be so designed that there are internal pressures to work towards the above goals. Needless to add, the regulatory system needs to be robust to supervise a competitive retirement funds industry.

5.1 Target Segment

While designing any scheme for old age income security, there is sometimes a feeling that it should take care of all old people. However, in a country like India, a distinction needs to be made between persons who are poor and unable to meet basic needs even during their working years and those who earn and are in a position to save for the future. A substantial segment of the population not covered by the second pillar at present such as agricultural workers and casual wage labor fall within the category of the poor. These segments would need to be targeted by the poverty alleviation programmes of the government whether during working years or old age which will need to be funded by the taxpayer. The second pillar needs to target those who earn adequately to meet their basic needs and are in a position to save a portion of their earnings for their old age. The New Framework should aim to obtain substantial coverage among the target segment rather than the whole population.

5.2 Mandatory or Voluntary

The debate whether schemes designed for self-employed or casual workers should be mandatory or voluntary is a long-standing one. Mandatory requirement is the cornerstone of the second pillar and even those schemes designed for the self-employed or casual workers should normally be mandatory as in the case of occupational schemes. Enforcement is, however, a major concern in the case of mandatory schemes applicable to individuals. While enforcement is relatively easy in the case of occupational schemes, it would be quite a task in the case of self-employed or unorganized sector.

At the same time, it is also necessary to appreciate the limitations of voluntary retirement schemes (which require locking-in savings for long periods) in expanding coverage. The Central Government already operates the Public Provident Fund (PPF), which is in the nature of a voluntary Individual Retirement Account. Coverage of the PPF has been limited. Often, bank branches are not even prepared to offer the product let alone provide good service. The experience of LIC and mutual funds, which also market voluntary retirement products supported by tax benefits, is similar. They have some penetration only among taxpayers.

5.3 Innovation in Enforcement

The necessity to have compulsory coverage is only limited by the enforcement difficulties. For this reason, innovations in enforcement need to be found. Some possible approaches are given below:

- A separate, elaborate enforcement structure need not necessarily be created for pension and provident funds. Reliance can be placed on existing enforcement agencies and specific responsibilities may be assigned to them. Some of the enforcement agencies that can be leveraged for enforcement of the second pillar would include income-tax authorities, municipal authorities or property-tax collecting agencies, sales-tax authorities for self-employed businessmen, RTO authorities for automobile owners, etc.
- Enforcement will need to be automatic or based on some databases. For example, a scheme mandatorily applicable to all owners of four wheelers can be enforced by checking of the deposit record by the RTO. There is no reason why enrolment into a mandatory provident fund cannot be checked by utility agencies providing cooking gas, telephone lines or electricity.
- Professional or trade associations can be leveraged to enforce coverage among their members.
- Involvement of a private retirement funds industry gives an impetus to enforcement since they would, in the interest of expanding their corpus, attempt to pursue violations.

Perhaps the most viable way to go would be to start small and introduce mandatory coverage among some segments of self-employed or casual workers, where enforcement is relatively easy. Some examples of such segments could be practicing chartered accountants enforced through the Institute of Chartered Accountants, practicing doctors enforced through the state medical councils, automobile owners enforced through the RTO. A demonstrative effect of achieving success in those segments could lead to introducing mandatory coverage in more difficult-to-enforce segments. At the same time, voluntary schemes need to be available which could grab coverage through aggressive marketing efforts of the retirement funds industry. Voluntary schemes may be converted to mandatory schemes over time.

5.4 Innovation in Scheme Design and Delivery

To effectively increase coverage especially among the self-employed and the casual workers, innovation in scheme design, delivery and administration would be essential. Tailor-made schemes may need to be formulated for various segments. Some of the critical requirements that the New Framework would need to put in place in this regard would be the following:

5.4.1 Individual Retirement Accounts

To extend coverage beyond regular salaried employees who participate in schemes designed and operated by the employer, an effective system of Individual Retirement Accounts (IRAs) will need to be established. The individual member takes initiative in establishing an IRA with an approved provider. At present, PPF is the principal method for an individual to have an IRA.

5.4.2 Portability

The retirement account would need to be portable to ensure continued accumulation of retirement savings. Portability is also important for emerging types of employment such as contractual employment, employment on retainer, part-time work, freelancing, work for multiple employers, assignment-based consulting work, telecommuting, etc. Portability is necessary to cover casual workers since they would work with many employers. The Provident Fund in India has features of portability since the accumulated balance can be transferred to the provident fund of the new employer. Portability of the Pension Fund is lot more complex since it is a defined benefit plan. Some Pension Funds in India have made provisions for payment of contributions, along with some interest, in case a member leaves the fund before retirement. Such models could be adopted to make the Pension Fund also portable. Individual Retirement Accounts as suggested above would, by their very nature, be portable.

5.4.3 Attractive Return

An attractive return will provide for better benefits with lower levels of contribution and thus for better old age security. Especially where participation is voluntary, and tax benefits are not important for a large segment of the population, only an attractive return can ensure high levels of participation. Since professional investment managers manage pension and provident funds, they should, over a long term, necessarily be able to achieve a higher return as compared to what the individual will be able to. Policies that direct funds into investments offering less than market returns or other restrictions that hamper achievement of an attractive yield would impede the establishment of a successful second pillar.

5.4.4 Accumulation for retirement years

Pension and Provident Funds need to restrict withdrawals during working years so as to ensure accumulation of adequate savings at the time of retirement. In India, the Schemes allow withdrawals easily for several non-retirement purposes such as marriage of daughter, education of children, etc. These need to be restricted. Though the Provident Fund is portable, there are provisions, which enable an employee to withdraw his balance on leaving the job by making a declaration that he does not plan to take up another job, thereby defeating the purpose of accumulation till retirement age.

5.4.5 Hassle-free Administration

To attract large segments of people to participate in the second pillar, the system of collection, administration and payments should be easy and hassle-free. Delivery is easy in the case of occupational schemes since the employees are all based in one or a few work locations. Schemes targeted at wider segments of people spread over a large geographical area need a well-designed administration system.

5.4.6 Possible Mandatory Schemes

In the US, the self-employed persons are also covered by the social security system. They need to make payment of payroll taxes similar to the employed persons as a percentage of their income as declared to the tax authorities. A similar system can be introduced in India for taxpayers who are self-employed. The income-tax authorities have also shown the way to expand coverage by defining certain criteria for mandatory filing of income-tax returns.

A possible mandatory scheme could be made applicable to all assesses who are required to file income-tax returns as per the stated criteria. While the threshold income level for applicability of income tax could be higher, the mandatory provident fund scheme could be made applicable to persons with income of a much lower limit. The contributions can also be linked to declared earnings as a percentage.

5.4.7 Tailor-made Schemes

Another method to increase coverage would be to design special schemes meant for a specified class of people. Depending upon the class of people, special enforcement and delivery mechanisms could also be devised using professional bodies, trade associations, utility services etc. A purely illustrative list of segments which could be covered in order to give an idea is as follows: practicing doctors, chartered accountants, lawyers, Mumbai taxi drivers, truck drivers, Shopkeepers in Mumbai occupying space of over 300 sq. ft. cultivators owning land of more than 5 acres, owners of rented commercial or residential property of more than 1000 sq. ft. etc. Though the EPF Act does provide for framing of different Schemes for different classes of establishments, only one general Scheme for provident funds has been framed which applies to all establishments covered by the Act. However, the Employees' Provident Funds Scheme, 1952 does contain special provisions relating to employees in newspaper establishments and cine workers where non-regular type of employment is prevalent. Certain criteria have been defined in the Scheme to determine the applicability of the Scheme to employees in such establishments.

Para 80 of the Scheme makes provident fund mandatorily applicable to every newspaper employee who has completed three months' continuous service or has actually worked for not less than 60 days during a period of three months or less in that newspaper establishment or in another such establishment to which the Act applies under the same employer or partly in one and partly in the other or has been declared permanent in any such newspaper establishment, whichever is the earliest.

Para 81 of the Scheme makes provident fund mandatorily applicable to every cine-worker employed to do any work, in or in relation to any feature film in a film production unit if he had worked in not less than three feature films with one or more producers. The Scheme also provides for the fact that remuneration in cine industry could be a lump sum for a feature film instead of monthly remuneration as is normal in other industries.

Tailor-made Schemes can thus be framed to expand coverage.

5.4.8 Establishment of a Regulatory Agency

To expand coverage in a country like India, there is need for an agency charged with the responsibility of constantly looking for ways to effectively increase coverage of the Second Pillar. A flavor of the ways in which more people could be brought into the net of old age income security has been given above. But such ideas will need be well-researched and robust Schemes drafted, debated and framed on an on-going basis.

Under the EPF&MF Act, the broad administrative responsibility vests with the Central Government. The Central Government has the power to expand coverage by notifying factories and classes of establishments to which the Act should apply. The Central Government also has the power to design and notify any Scheme, which complies with requirements laid down in the Act. The Central Board of Trustees only administers the Schemes that have been framed. Since the types of Schemes that can be framed are "hard coded" in the Act, formulation of any new Scheme requires amendment to the Act. All modifications to the existing Schemes as also notifications issued to expand coverage are also required to be laid before both Houses of the Parliament.

A- Provident and Pension Funds Authority of India (PPFAI)

It is suggested that a Provident and Pension Funds Authority of India (PPFAI) be established to develop the Second Pillar by expanding coverage and regulate the Provident and Pension Funds in the country. Parliament should define the objectives for the Authority as follows:

- To take effective steps to expand coverage and bring in larger number of people within the net of provident and pension funds; monitor the extent and adequacy of coverage regularly
- To make provident and pension funds an effective instrument for old age income security and work towards enhancing the benefits to contribution ratio
- To provide for protection of members' interests and ensure efficient service
- To exercise regulatory oversight on the entire retirement funds industry and intermediaries involved therein
- To promote vibrant growth of the retirement funds industry

Considering the importance of social security schemes, the role of the Parliament in debating scheme design may be retained. The schemes formulated by the Authority may be laid before the Parliament who shall have the freedom to review the same.

B- Regulatory and Developmental Functions

In the area of provident and pension funds, the developmental role of the agency in expanding coverage is as important as its regulatory functions. The developmental role needs to be given adequate emphasis in the mandate of the agency.

C- Removal of "dual control" by tax authorities

For simpler and more effective supervision, the dual control of the tax authorities on provident and pension funds needs to be removed. At present, funds such as the EPF and CMPF are exempt from income tax under Section 10 of the Income Tax Act. Other exempted funds need to get recognition from tax authorities in order to be eligible for tax exemption. Schedule IV to the Income Tax Act lays down requirements to be fulfilled by the Recognized Provident Funds, including adherence to an investment pattern prescribed by the Central Government. Matters such as investment pattern are today prescribed by the Ministry of Finance under the Income Tax Act as also by the Ministry of Labor under the EPF & MP Act. Such dual control causes avoidable confusion.

All approved providers recognized by PPFAI need to be automatically eligible for tax exemption under the Income Tax Act. A parallel exists under the Income Tax Act, where all mutual funds approved by SEBI are entitled to tax exemption. Similarly, all Schemes approved by PPFAI should be eligible for tax benefits subject to such limits as may be specified under the Income Tax Act.

D- Coverage of Establishments as well as Individuals The New Framework should cover not only establishments, but also individuals.

- Expanded coverage of establishments: Coverage of the EPF&MP Act is at present restricted to factories and other establishments, employing 20 or more persons. It is suggested that coverage should be made universal under the New Framework by making provident fund mandatorily applicable to all establishments where employer-employee relationship exists. There need be no mention of the minimum number of employees in the Act. Such matters should be covered in the Scheme. It makes for easier changes in future and gives the flexibility to fix different minimum in different schemes aimed at specific types of establishments.
- Coverage of individuals: Coverage of the law needs to be extended to individuals also. The new law needs to empower the Central Government to make the Act applicable to any person or class of persons by notification of a Scheme covering such person or class of persons. Formulation and notification

of any Scheme by the Central Government should be on the recommendation of the PPFAI.

- Mandatory or Voluntary: This should be left to PPFAI While occupational schemes should be mandatory as at present, PPFAI needs to be given the option to make Schemes mandatory or voluntary as far as individuals are concerned. Whether the Scheme would be mandatory or voluntary would be specified in the notification, which would bring the Scheme into force. PPFAI will need to put in place
  - Effective enforcement in the case of mandatory schemes, and
  - Effective marketing to expand coverage in the case of voluntary schemes
- Schemes as 'Minimum Requirements: At present, the Schemes that can be formulated are "hard coded" in the Act. Only three Schemes are possible: the Provident Fund Scheme under Section 5, the Pension Scheme under Section 6A and the Deposit-linked Insurance Scheme under Section 6C. Matters that can be provided for in the Schemes are also laid down in Schedules II, III and IV to the Act. Every Scheme and every modification thereto needs to be laid before both houses of Parliament. This reduces flexibility in formulation of any Scheme. The New Framework should not limit the formulation of innovative schemes. PPFAI should have the freedom to notify as many schemes as required targeting specific persons or classes of persons. Instead of specifying full details of the Scheme as at present, PPFAI should specify "minimum requirements" that a Scheme should fulfill such as minimum contributions and benefits, minimum restrictions on withdrawals during working years, lump sum or annuity payments, nomination facility, minimum vesting and funding requirements, disclosure and reports etc and then let the market design and innovate schemes that fulfill the minimum requirements. Under the New Framework "approved providers" (discussed below) offer the schemes, while PPFAI only lays down the minimum requirements. An analogy would be the Guidelines for Equity Linked Savings Schemes framed by the Government. Any mutual fund can structure a Scheme in conformity with the guidelines and be eligible for the tax benefits provided to such Schemes.
- Occupational Plans: Under the present structure, every establishment to which the EPF&MF Act applies is required to join the Funds operated by the EPFO under the Central Board of Trustees. Any employer wishing not to join the same may set up an independent trust and apply for exemption under Section 17 of the Act. As such, there are only two approved providers for occupational plans:
  - EPFO
  - Exempted trusts set up by the employer himself. An exempted trust may, however, cater only to employees of that establishment.
  - There is no professional or private alternative. Employers who are not keen to undertake the hassle of setting up and operating their own trusts have no alternative but to join the government-operated fund. The government-operated EPF is also the only pooling arrangement for multiple employers. An employer who employs a smaller number of employees where operation of an independent trust may not be a viable proposition is compelled to join the EPF.

There is need for an alternative to EPF that an employer may join in case he does not wish to set up and operate his own exempted trust. If alternatives providing effective management and good service are available, the number of exempted funds may come down sharply and larger and more professionally managed funds may emerge. The New Framework should provide for approved providers who can offer pension and provident fund schemes. The approved providers need to seek authorization from PPFAI before they can start operations and be bound by the rules, regulations and code of conduct laid down by PPFAI.

Two Choices for "Approved Providers"

India has two choices while defining approved providers:

- 401(k) Model: Any bank, mutual fund or insurance company may be permitted to offer pension products eligible for tax benefits applicable to such products. In this model, banks, financial institutions, life insurance companies and mutual funds existing in India may be allowed to become approved providers. They would continue to be regulated by the respective regulatory agencies.
- Chilean Model: Specially established pension companies or trusts alone may be allowed to offer pension products eligible for mandatory coverage and applicable tax benefits. These providers would be regulated by the pension regulatory agency.

India at present follows the "exclusive provider" approach. Both EPFO and the exempted trusts are exclusive providers of pension and provident fund products. They do not mix them up with any other bond, deposit, mutual fund or insurance products. It is recommended that the same approach may be continued, by requiring approved providers to exclusively offer only pension and provident fund products. This would also ensure clear segregation of regulatory turfs. An approved provider would be required to set up a trust, which may be sponsored by any financial institution, bank or a foreign institution with experience and assets over a specified level. The trust may set up its own infrastructure or engage a professional administrator (to maintain records), a custodian (for transaction processing and safe custody of securities) and a fund manager (for investment management).

Schemes to the approved by PPFAI

Every approved provider may operate Schemes, which may be occupational schemes aimed at employees of an establishment or individual retirement account plans aimed at individuals. Every Scheme so operated should have an Offer Document, which will be vetted by the PPFAI.

EPF to be an approved provider

EPF would also be an approved provider though government-operated and would function under the same framework applicable to private providers. A healthy competition between EPF and private providers may be expected to benefit the members of funds by way of better returns and better service.

Approved Service Providers

The approved providers who are set up as independent trusts may be given the option to engage professional service providers. These may be termed "approved service providers". At present, a provident or pension fund may engage any service provider without requiring that they be properly authorized. In order to ensure that the service providers are held accountable for their conduct and performance, it is necessary to introduce the concept of "approved service providers". These may be:

- For Funds Management
  - Any bank or financial institution
  - Any SEBI authorized Asset Management Company
  - Any SEBI authorized Portfolio Manager
- For Custodial Functions
  - Any SEBI approved custodian
- For Record-keeping and Administration
  - Any SEBI approved custodian
  - Any firm of chartered accountants

Other Funds

There is a case to declare other funds such as CMPF, Seamen's fund, etc also as approved providers and bring them under the regulatory supervision of the PPFAI. Every employer would have the choice to join EPF, any private provider or set up his own exempted trust. Initially, the employer may be given the option to choose the provider and all employees would be required to join the same. After gaining some experience with the system, individual employees may be given the choice to join any provider they may choose.

Number of providers

It may be important to limit the number of private providers to 10-15. This would ensure that large, credible players would emerge. It would also pave the way for better regulation.

5.5 Contributions

Contributions to the Schemes under the EPF&MP Act are given statutory force under Section 6 of the Act. The employer's and employee's contribution has been specified at 10% each of the basic wages, dearness allowance and retaining allowance, with the power to the Central Government to increase it to 12% each for any establishment or class of establishments. The employee is entitled to contribute more than the minimum to his provident fund, but the employer shall be under no obligation to contribute more than the minimum required. However according to a ruling of The Bombay High Court in RPFC v. Ganesh Dyeing & Printing Works the liability of the employer is not to be increased beyond the clear intent of Parliament.[1]." In a large number of industries, the applicable contribution rates are 12% for the employee and 12% for the employee. This means that 24% of the wages of an employee are mandatorily saved in a provident or pension fund scheme. In other industries it is 20%, consisting of 10% each from the employee and the employer. These are substantial amounts, fairly close to the savings rate in the economy, which in any case is among the higher in the World.

Assuming a starting annual salary of Rs.1 lakh, real growth in salary of 3% p.a., provident fund contribution of 24% and investment return of 3% p.a., the accumulation in Provident Fund at the end of a 30-year working career would be Rs Rs 16.97 lakhs. This amount would equivalent to an annuity of Rs 1.42 lakhs per annum for 15 years assuming the same real return on investment of 3%. The annuity translates into a replacement rate of 60% on his annual salary of Rs 2.36 lakhs in the 30th year based on the above assumptions. A 1% increase in real rate of return will increase the replacement rate to 70% and a 2% increase will push it up further to 81%. For just the second pillar, to be supplemented by voluntary savings, it would be a very healthy or even high replacement rate. The contributions however are determined with reference to basic wages, dearness allowance and retaining allowance paid to the employee. Allowances such as special allowance, transport allowance, city compensatory allowance etc and bonus, which are often structured as part of the compensation package, are not included for the purpose of provident fund contributions. As a result, the replacement rate works only on a part of the salary and hence would be lower on total compensation package. It is necessary to plug this loophole to bring all cash components of the salary into the PF net. In a liberalized economy, more compensation is likely to be structured by way of bonus based on performance. Such incentives should also be subjected to provident fund. Simultaneously, the percentage contribution can be reduced to lessen the burden on the employer and the employee. A restructuring of contribution computation as a percentage of all wage components will enable targeting

[1] The court said, "To the extent that this is social legislation and caters for the social good, it must receive a benevolent interpretation at our hands. But, in giving a benevolent interpretation to the Act, we must not also overlook the fact that it constitutes a levy or a charge upon the employer and to that extent we must be careful in seeing that the liability of the employer is not increased beyond what Parliament clearly intended

the replacement rate in a more realistic manner.

5.5.1 Benefit Design

EPF&MF Act gives power to the Central Government to frame three schemes by notification in the Official Gazette:

1. Employees' Provident Fund Scheme under Section 5
2. Employees' Pension Scheme under Section 6A
3. Employees' Deposit-Linked Insurance Scheme under Section 6C

The matters that may be provided for in these Schemes are laid down in Schedules II, III and IV of the Act respectively.

The Central Government has the power to modify any of the above Schemes by notification in the Official Gazette [Section 7]. Every Scheme framed under Sections 5, 6A or 6C and every modification under Section 7 is required to be laid before each House of Parliament, and if both Houses so agree, the Scheme or modification may be annulled or amended. The Act establishes three Funds to hold the assets under the above Schemes. The Funds vest in and are administered by the Central Board of Trustees constituted under Section 5A of the Act.

Protection against attachment

Section 10 of the Act provides that the amount standing to the credit of any member of a provident fund shall not be capable of being assigned or charged and shall not be liable to attachment under any decree or order of any court in respect of any debt or liability incurred by the member even in the event of his insolvency. The provision applies not only to the Employees' Provident Fund, but also to every exempted provident fund. In the case of death of a member, the amount shall vest in the nominee and shall be free from any debt or other liability incurred by the deceased member or the nominee. The provision also applies in respect of any amount payable under the Employees' Pension Scheme and the Insurance Scheme (Section 10). However, the immunity exists only as long as the money is held in the provident fund account, but not after it has been paid to the member.

Assessment of Benefits

The major drawbacks in the present benefit structure are as follows:

1. There are no medical benefits. Medical expenses generally tend to be higher during old age. A part of the contributions needs to be diverted to provide for effective medical insurance during old age.

2. Provident Fund pays lump-sum on retirement, leaving it to the retired employee to manage savings during old age. A portion of the accumulation needs to be paid in the form of annuity so that there is better protection against imprudent investment management and averaging across the members to ensure that savings do not run out during one's lifetime.
3. Withdrawals from provident fund are easy and portability is not effective. As a result, there may not be adequate accumulation at the time a person reaches old age. Withdrawals need to be restricted and portability made more effective to ensure availability of sufficient balance in the account.

Under the New Framework, benefit structure should include medical insurance. A small portion of the contributions can be diverted to purchase an effective mediclaim policy from an insurance provider. A portion of the accumulated balance in the provident fund needs to be used compulsorily to purchase a life annuity for the employee and his dependents. The annuity may be purchased from an annuity provider, or the fund may provide the annuity itself. Withdrawals need to be restricted. Refundable loans may be encouraged as compared to the non-refundable loans at present. Portability needs to be made more effective.

5.5.2 Enforcement Responsibility

Responsibility fixed on the employer

The principal duty imposed by the Act upon the employer is to put the scheme into operation in his establishment and make contribution in respect of his share as well as the employees' share to the fund and deduct from the wage of the employees their share. Fixing responsibility upon the employer therefore, reduces the enforcement burden of the Act. The employer is required to contribute the employees' share even if he is unable to recover the same from their wages for any reason. It is also the employer's responsibility to put the scheme into operation as soon as the Act becomes applicable to his establishment. No further notice by any authority is necessary. If it is discovered by the authorities that the Act applied to an establishment from an earlier date, the employer is liable to pay both the employer's and employees' contributions for the pre-discovery period.

There is no option on part of the employees either. Neither the Act nor the Scheme permits an option to employees to pay or not to pay their contributions. Responsibility has also been fixed on the employer for payment of both employer's and employees' contributions in respect of persons employed by him by or through a contractor. The employer may, however, deduct such amounts including administrative charges from any payments due to the contractor or recover the same as a debt payable by the contractor. The contractor in turn may deduct the employees' contributions from the wages payable to the employees (Section 8A).

Methods of Recovery of Contributions

As the contributions are mandatory, the Act lays down detailed provisions for recovery of the same. All amounts due under the Act including employer's and employees' contributions, administrative charges, damages and accumulations required to be transferred by an exempted fund in respect of which exemption has been withdrawn can be recovered in the manner specified in Sections 8B to 8G of the Act (Section 8).

1. Interest on delayed payments: In case of delay in payment of any amount due, the employer shall be liable to pay simple interest at the rate of 12% p.a. or such higher rate as may be specified in the Scheme. The rate shall, however, not exceed the lending rate of interest charged by any scheduled bank (Section 7Q).
2. Recovery through a Recovery Officer: Arrears of amount due under the Act from an employer may be recovered in the same manner as arrears of land revenue.Where there are arrears, on issuance of a certificate by the authorized officer, the Recovery Officer may proceed to recover the arrears by
    - Attachment and sale of the movable or immovable property of the establishment or the employer, or
    - Arrest of the employer and his detention in prison, or
    - Appointing a receiver for the management of the movable or immovable properties of the establishment or the employer (Section 8B).
3. Recovery through any person owing money to the employer If any amount is due from any person to any employer who is in arrears, the Central Provident Fund Commissioner or any other officer so authorized may require such person to deduct the amount of arrears and pay the same to the credit of the Central Provident Fund Commissioner or the authorized officer (Section 8F). Any person to whom such notice is issued is bound to comply with the same, including a post office, a bank or an insurer. The Act specifically provides that it shall not be necessary to produce any passbook, deposit receipt, policy or any other document that may normally be required to be produced before making a payment. A receipt issued by the Central Provident Fund Commissioner or other authorized person shall be a full discharge of such person's liability to the employer. 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.
4. Recovery out of money in custody of court Where any money belonging to the employer is in custody of a court, the Central Provident Fund Commissioner or other authorized officer may apply to the court for payment of amounts in arrear from the employer.
5. Recovery by sale of property Where so authorized 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.

6. 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.

7. Provisions in the case of employers in financial difficulties

   The Central Provident Fund Commissioner has framed guidelines for acceptance of arrears in installments, especially in the case of companies, which are declared sick by the Board for Industrial and Financial Restructuring (BIFR).

8. Applicability to Exempted Funds

   The methods of recovery laid down above are available under the Act to the Exempted Funds also in case of default by the employer in payment of contributions or charges to the Exempted Fund. The responsibility on the employer and methods of recovery laid down in the Act are comprehensive and effective and would need to be retained under the New Framework. If there are any improvements that could be made to these provisions, they would need come from the experience of EPFO in applying these provisions. 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. Such a provision should be included in the New Framework. In the case of Schemes aimed at individuals, even if mandatory, recovery procedure of the nature specified by the Act for occupational schemes does not appear appropriate. An individual's mandatory Scheme should be treated as a contractual savings scheme, such as a life policy. Default in payment during the life of the contract should be penalized by way of financial losses of deposits already made due to breach of contract.

5.5.3 Administration

Central Board of Trustees

The Administration of the three Funds under the EPF&MP Act vests in a Central Board of Trustees constituted under Section 5A of the Act. The Central Board can consist upto 43 persons, all appointed by the Central Government: a Chairman, a Vice Chairman, the Central Provident Fund Commissioner, 5 officials of the Central Government, 15 representatives of the State Governments, 10 representatives of the employers and 10 representatives of the employees.

The Central Board has been constituted as a body corporate, with perpetual succession and common seal.

Executive Committee

Section 5AA of the Act provides for constitution of an Executive Committee to assist the Central Board in the performance of its duties. The Executive Committee is drawn from among the members of the Central Board and may consist upto 13 members: a Chairman, the Central Provident Fund Commissioner, 2 officials of the Central Government, 3 representatives of the State Government, 3 representatives of the employers and 3 representatives of the employees.

EPF Administrative Officers

The Central Government is empowered to appoint

- The Central Provident Fund Commissioner, who shall be the Chief Executive Officer of the Central Board and be subject to the general control and superintendence of the Central Board.
- A Financial Adviser and Chief Accounts Officer to assist the Central Provident Fund Commissioner in the discharge of his duties.

The method of recruitment, salary and allowances, discipline and other conditions of service of these officials shall be such as may be specified by the Central Government. The Central Board has been given powers to appoint other officers. The Central Board may appoint as many Additional Provident Fund Commissioners, Deputy Provident Fund Commissioners, Regional Provident Fund Commissioners, Assistant Provident Fund Commissioners as it may consider necessary for efficient administration of the Schemes. The appointment of officers by the Central Board shall be subject to the maximum scale of pay specified in the Scheme and the method of recruitment, salary and allowances, discipline and other terms and conditions of service shall be in accordance with the rules and orders applicable to the officers and employees of the Central Government drawing corresponding scales of pay. Where the Central Board is of the opinion that it is necessary to make a departure, it shall obtain the prior approval of the Central Government. In case of any doubt in such matters, the Central Board is required to refer the matter to the Central Government, whose decision shall be final. No appointments of the Central Provident Fund Commissioner, an Additional Provident Fund Commissioner, the Financial Adviser and Chief Accounts Officer and any other officer carrying a scale of pay equivalent to any Group A or Group B post under the Central Government shall be made except after consultation with the Union Public Service Commission unless the person is a member of the Indian Administrative Service or is in the service of the Central or a Government in a Group A or Group B post. No consultation is required if the appointment is for a period not exceeding one year.

Administrative Ministry

The entire EPF administration functions under the control of the Ministry of labor

State Boards

Section 5B provides for constitution of State Boards. The Central Government may, after consultation with the State Government, constitute a State Board of Trustees for that State. The State Board shall exercise such powers as may be assigned to it by the Central Government from time to time. Each State Board is also constituted as a body corporate. A State Board may appoint such staff as it may consider necessary with the approval of the State Government. The method of recruitment, salary and allowances, discipline and other conditions of service of such staff shall be such as may be specified by the Board with the approval of the State Government.

Delegation

Section 5E empowers the Central Board and a State Board to delegate any of its powers and functions to the Executive Committee, Chairman of the Board or any of its officers.

Supervision of the Central Board

The Central Board is required to maintain proper accounts in the manner specified by the Central Government, after consultation with the Comptroller and Auditor General of India (CAG). The accounts of the Central Board are subject to audit by the CAG. The Central Board is required to forward the annual accounts along with its comments on the report of the CAG to the Central Government. The Central Board is also required to submit an annual report of its work and activities to the Central Government. The Central Government is required to lay before each House of Parliament, the annual report of working and the audited accounts of the Central Board.

The Central Board of Trustees at present functions both as a regulator as far as exempted funds are concerned and as a player by operating the largest provident and pension funds in the country. There is need to segregate these functions. The regulatory and supervisory functions need to transferred to the proposed Provident and Pension Funds Authority of India. In addition to the supervisory functions of the EPFO, the PPFAI need also be transferred all the responsibilities and powers of the Central Government for effective development of the provident and pension fund industry in India.

EPFO needs to be reorganized into two parts. The supervisory and regulatory functions and corresponding staff need to be spun off into PPFAI. The operating functions which administers the funds under the control of EPFO should become an approved provider under the supervision of PPFAI. PPFAI needs to have a smaller board as compared to the Central Board of

Trustees for effective functioning. It also needs a lot of flexibility in administrative and human resource matters in order to develop a good team.

5.5.4 Enforcement

Dispute Resolution

Commissioners specified under the Act have been given powers to decide on disputes regarding applicability of the Act to an establishment and determine the amounts due from an employer under any provisions of the Act or the Schemes (Section 7A). Such powers have been vested with the Central Provident Fund Commissioner, any Additional Provident Fund Commissioner, any Deputy Provident Fund Commissioner or any Assistant Provident Fund Commissioner.

An enquiry is required to be conducted before passing an order. The officer conducting the enquiry has been conferred the same powers as are vested in a court under the Code of Civil Procedure, 1908 for trying a suit in respect of enforcing the attendance of any person or examining him on oath, requiring the discovery and production of documents, receiving evidence on affidavit and issuing commissions for the examination of witnesses. Such enquiry shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 and for the purpose of Section 196 of the Indian Penal Code. No order shall be made unless the employer has been given a reasonable opportunity of representing his case.

The order passed by the Commissioner is final and it is not justiciable in civil court. The order being a quasi-judicial order and directly affecting the civil rights of the employer must be a speaking order. The order must be made indicating the basis of the calculation on which the demand was determined (Chetram Aggrawal v. RPFC). An infirmity in the order can entitle the employer to seek relief in the court in a writ petition under Article 226 of the Constitution of India.

Inspectors

Section 13 provides for appointment of inspectors for the purposes of the Act. The power to appoint inspectors vests in the appropriate government. The Central Government is the appropriate government in relation to an establishment belonging to or under the control of the Central Government, a railways company, a major port, a mine or an oil field or a controlled industry or in relation to an establishment having departments or branches in more than one Sate. In respect of all other establishments, the State Government is the appropriate government. While appointing inspectors, the appropriate government may define their jurisdiction.

Appellate Tribunals

Section 7D empowers the Central Government to constitute, by notification in the Official Gazette, one or more Appellate Tribunals to be known as Employees' Provident Funds Appellate Tribunals. Each such Tribunal shall have jurisdiction in respect of establishments situated in such area as may be specified in the notification. A Tribunal shall consist of only one person to be appointed by the Central Government, who is qualified to be a judge of a High Court or a District Judge. The Central Government shall determine the nature and categories of the officers and other employees required to assist a Tribunal in the discharge of its functions and provide the Tribunal with such officers and other employees as it may think fit. Any person aggrieved by

- A notification issued by the Central Government or an order passed by the Central Government or any authority extending the application of the Act to establishments employing less than 20 persons (under sub-section (3) of Section 1)
- A notification issued by the Central Government under Section 3 applying the Act to an establishment which has a common provident fund with another establishment
- An order passed by a Commissioner under Section 7A deciding on disputes relating to applicability of the Act and the determination of the amounts due from an employer
- Section 7B, 7C and 14 B

may prefer an appeal to a Tribunal against such notification or order. A Tribunal also has the powers of a civil court for trying a suit and any proceeding before a Tribunal shall be deemed to be a judicial proceeding. The Tribunal shall be deemed to be a civil court for all purposes of Section 195 and Chapter XXIV of the Code of Criminal Procedure, 1973. Any order made by a Tribunal finally disposing of an appeal shall not be questioned in any Court of Law. The enforcement functions will need to be transferred to PPFAI. PPFAI rather than the appropriate government would need to do appointment of inspectors. A Tribunal may, however, be retained for appeals against the decisions of PPFAI.