

India Life Hewitt

**Background Note
On
Exempt Provident Fund Reforms**

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EXECUTIVE SUMMARY

Process of Exemption

- Review current process that is time and paper intensive
- Consider procedure by which new companies who satisfy clear criteria will not be required to comply as un-exempt if they file for exemption within 30 days of coverage. Such companies will pay EPS/ EDLI but pay contributions into a trust.
- Time bound grant of exemptions (60 days from RPFC, 60 days from CPFC)
- Review and notify clear guidelines for eligibility (eliminate minimum 200 employees, profitability, etc) and consider interim relaxation orders
- Grant increased flexibility in restructuring scenarios such as mergers, etc for resultant entity to choose methodology of compliance under the Act.

Operational Issues

- Create infrastructure for E-filing and allow E-transactions to facilitate efficiency
- Transfer Funds after exemption within tight time lines

Specific Issues

- Allow the formation of Multi-Company exempt PF trusts for employee friendliness, economies of scale and reduced cost
- Allow the transfer of balances from exempt trusts to excluded trusts to increase labor mobility and meet the objective of long term savings
- Allow investment flexibility within prescribed guidelines to maximize yield and improve efficiency

Creation of Licensed Pension Administrators

- Grant licenses to Pension Administrators (LPAs) based on clear criteria of net worth, experience, infrastructure, etc
- Make LPAs responsible for compliance and benefits administration.
- All LPAs that would like to offer investment services should get a Portfolio Management Licence from SEBI.

Voluntary Self-Regulation by India Life

- Pending the evolution of a regulatory framework, India Life would like to submit to voluntary self regulation
- India Life will submit monthly formats to the CPFC on number of trusts handled, their compliance status and other details.

SECTION II. PROCESS OF EXEMPTION

The current process of obtaining exemption is very time and paper intensive and leads to inordinate delays before genuine exemption applications are processed and notified. This is particularly apparent in the case of new companies and established companies that are undergoing some kind of restructuring.

2.1 OPTIONS FOR NEW COMPANIES

Current Scenario:

- 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
 - On obtaining exemption, transfer of balances of individual employees back to the Exempt Trust.
 - This exercise involves the EPFO allocating resources for an employer who, in any case, wants an exemption.

Suggestion:

- Companies will 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 continued to remit their PF contributions to their own Provident Fund Trust, provided they apply for exemption along with their coverage application to EPFO.
- They may, however, be asked to 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.

2.2 OPTIONS FOR EXISTING UN-EXEMPT ESTABLISHMENTS

Current Scenario

Companies complying as un-exempt desiring exemption are now forced to go through a tedious process before their exempt status is notified. The following is the current sequence for obtaining Exemption

- Set up of the PF Trust
 - Recognition by the Commissioner of Income Tax
 - Application to the RPFC with
 - Proforma of application
 - Details of contractors
 - Consent Signatures of majority of employees
 - Comparison between the trust rules and PF Scheme
 - On filing of Application with RPFC, inspection of the Company for ensuring compliance status
 - RPFC recommendation to CPFC based on the report by the inspector
 - CPFC recommendation to appropriate government.
 - Notification by the Appropriate Government
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- The entire process takes more than a year and depending upon the appropriate government, often gets delayed beyond that period.
 - The power granted to RPFCs under Para 79 of the EPF Scheme 1952 to issue relaxation orders now stand withdrawn.
 - The delay causes avoidable friction between the Companies and the EPFO, with the applicants for exemption left to feel aggrieved at the whole situation.
 - The EPFO concern over the history of relaxed/exempt trusts and some abuses is valid and borne out by the facts
 - The remedy of the situation is to ensure that genuine cases are not clubbed with the companies that do not have good intentions or are not operating in good faith.
 - The key is to ensure that only the compliant and good corporate citizens are granted relaxation/exemption and on grant of such exemption the continuation of relaxation/exemption is strictly dependent upon the performance.

Suggestions:

- Specify clear guidelines (size of employees, base of calculation, profitability, etc) and simple documentation so multiple iterations and interpretations are minimized.
- The concept of economic size only after 200 employees merits review under the current scenario. The more appropriate variable is the size of the wage bill and there are a number of companies with less than 200 employees but whose high wages ensure the viability of the trust.
- Re-instating the power of relaxation to RPFCs with a caveat that only if the RPFC is satisfied about the 100% compliance status.
- 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 60 days of complete application RPFC to forward the application to CPFC and within 60 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 establishments against arbitrary decisions at RPFC levels.

2.3 RESTRUCTURING SCENARIOS FOR EXISTING COMPANIES

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.

Though this started with multinational companies, indigenous industry is also going through this process to keep itself competitive. Furthermore, global mergers mean that restructuring happening across the world results in implementation issues by their Indian subsidiaries.

The current framework of PF 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:

2.3A An exempt establishment merging with an un-exempt establishment

The view taken by some of the RPFs is that the exemption is granted to an establishment. When an exempt establishment merges with an un-exempt establishment it loses its identity along with its exemption.

Such an interpretation would result in considerable inconvenience to the exempt establishment as well as to the EPFO.

- The trust would have to be disbanded and balances transferred to the EPFO;
 - Not an acceptable alternative to the employees who have enjoyed the exempt status
 - EPFO is burdened with employees whose PF affairs could continue to be handled by the final entity.

It would be ideal to allow the un-exempt establishment to participate into the exempt trust of the merged establishment.

2.3B Merger of two exempt establishments

There is no clarity in such a scenario as to whether the merged establishment could make use of one single trust to cover all its employees.

In such scenarios, if the exempt trusts are allowed to merge,

- Would be able to provide better services to the Employees at a lesser cost and administrative hassles.
- Merged establishments could provide uniform benefits to their employees.
- This would also ensure easier regulation and monitoring by EPFO from one location.

2.3C De-merger of Establishment with an exempt trust

De-merger of an establishment is often the result of hive of business divisions or factories by companies either through a scheme of restructuring approved by high court or through a sale of undertaking.

If such an establishment was an exempt establishment the employees forming part of the hived of unit or division end up losing their status as exempt employees as the EPFO insists that the resultant establishment shall start complying as an un-exempt establishment.

The resultant establishment is not given time to set up their own trusts and obtain exemption. Even if allowed, the process of exemption is long winding leading to considerable difficulties for establishments and employees.

2.3D Merger of Establishments located under different RPFC/APFC jurisdictions:

The merger of establishments located under different jurisdictions or different states. This often leads to RPFCs or Sub Offices of EPFO taking diametrically opposing views on the situations.

Suggestions on Restructuring Scenarios:

- Resultant Entity of any type of Restructuring shall be allowed to choose the compliance option.
- De-merged Establishments 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 establishments, RPFCs may allow the merged establishment 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.

SECTION III. OPERATIONAL ISSUES

3.1 E-INFRASTRUCTURE FOR FILINGS AND TRANSACTIONS

- We appreciate that the EPFO is moving towards an Electronic Infrastructure that would change the whole face of the organization.
- In its effort to reengineer its processes internally, it should provide for electronic infrastructure, which will take care of its interface with the employers.
- This could be achieved to a great extent by way of providing for electronic filing of returns and electronic remittance of contributions to the EPFO.

E – Filing

EPFO's Information Technology infrastructure could provide for:

- a) Filing of returns via Internet; an employer with a distinctive Identification number and password shall be able to access the EPFO database to file his monthly and yearly returns over the Internet.
- b) The IT infrastructure shall be able to generate acknowledgements in proof of filing of returns.
- c) The IT infrastructure shall also enable the employer to submit applications on behalf of its employees for various transactions such as settlements/loans etc.
- d) The employer shall be able to file the nomination and other details of its employees through electronic media.

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.
- Currently, exempt trusts are forced to maintain all their back up papers in hard copy format. These include nomination and declaration papers, loan applications, and settlement applications. This is despite a well-developed Information Technology infrastructure within the exempted establishment.
- In the absence of hard copy of documents, the EPFO inspectors during the annual inspection dispute the veracity of many a transactions of the trust.
- We would therefore suggest that the exempted trusts should be allowed to operate based on the electronic documents.
 - This would facilitate easier administration of the trust.
 - The application processing is made easier in this process leading to efficient service to the employee.
- Infrastructure is already available with the exempted companies to provide for electronic workflow in applying for various benefits of the exempt trusts, approval of applications, processing of such applications and payment of various benefits to the employees.

3.2 TRANSFER OF FUNDS TO EXEMPT TRUSTS

- The transfer of funds to Trusts on exemption/relaxation takes a lot of time. The employees and the establishment are put to lot of inconveniences.
- Till the time of transfer of all the amounts, the employees are forced to make applications to the trust and to RPFC for settlements, loans etc.
- It also strains the trusts return on investments as the trust operates on a lesser corpus. Delay is normally caused due to the time taken to reconcile the accounts of the individual employee balances of at the RPFC.

Suggestion:

- The first tranche in cash may be transferred immediately based on the updation accounts till date. (Based on the Annual Statements issued till the end of the previous financial year)
- On finalization of accounts till the date of exemption the balance may be paid to the Exempt Trust after making the adjustments for the cash and securities proportions (85:15).

SECTION IV. SPECIFIC ISSUES

4.1 FORMATION OF MULTI-COMPANY EXEMPT TRUSTS

Background

- A number of businesses (Indian Groups, MNCs, etc) have multiple legal operating entities for strategic and business reasons. A number of these companies would prefer to provide Provident Fund benefits to employees across the group in a single trust.
- Current provisions of the PF act allow participation into an exempt trust by 6 participating units. However, there is no clarity on the definition of a participating unit with different interpretations by different RPFs (factories, offices, legal entities, etc)
- Most established Industrial houses have one or more of the companies that operate exempt trusts. However due to the unclear position of EPFO on this, other group companies are currently not participating into such trusts.

Possible Advantages of Multi-Company Trusts

- Reduced administrative complexity
- Total Cost Reduction
- Harmonization of benefits and trust rules
- Economies of scale and scope
- Employee friendliness in case of intra-group transfers
- Single window for compliance and higher ability for supervision

Suggestion

- A group of companies should be allowed to obtain exemption and operate a trust for all the member companies of the Group.
- If an exempted trust is already in existence, other members of the group as well as newly established member companies of the group should be allowed to participate automatically into such group companies.

4.2 TRANSFER OF BALANCES TO EXCLUDED TRUSTS

Background

- A number of companies have set up provident fund trusts for the benefit of employees who are excluded employees as defined under the PF Scheme. (Only employees who are starting their career with a PF salary over and above Rs. 6,500/- per month)
- Alternatively, an employee drawing salary more than the said threshold should have withdrawn all his earlier Provident Fund balances from the RPFC or an exempt trust. This clause effectively defeats the purpose of providing for excluded employee concept beyond the prescribed threshold.
- This clause forces employers to cover an employee with a previous RPFC balance under the EPFO even though his salary may be few multiples of the excluded employee threshold.
- Employees tend to give wrong declarations about their prior status and participate in the Excluded Employees PF Trust by withdrawing their earlier balances.

Possible advantages of allowing transfer to excluded trusts

- Discouraging withdrawal of balance on movement from exempt to excluded trusts. This will ensure that the accumulation amount at retirement is not compromised.
- Higher portability for employees as they advance in their careers and move across and between industries and companies.

Suggestions

- Redefine the concept of excluded employees, by treating all employees as those drawing PF salary beyond the threshold limit of Rs.6, 500/- as excluded employees.
- Allow transfer of RPFC balances into the Excluded Provident Fund Trusts. EPFO may insist on a certain level of compliance by insisting on reporting requirements to be met by such trusts to safeguard the interest of the employees.

4.3 INVESTMENTS – FLEXIBILITY WITHIN PRESCRIBED PATTERN

Background

- Trustees have to approach the RPFC for approval every time there is a need to sell the securities even in the case of genuine requirements such as VRS settlements.
- Trustees are not allowed to restructure the Investment Portfolio even within the mandated investment pattern.

Possible advantages of investment flexibility within prescribed

- Higher returns; Trustees could use the opportunities available in the market to optimize the returns to the trust.
- Employee settlements will happen faster and more efficiently
- Trusts could use scientific methods of asset and liability management to ensure that the objectives of risk and portfolio management are met

Suggestion:

- Trustees may be allowed to liquidate SDS and other investments for the purpose of contingencies such as VRS.
- The trustees may be allowed to restructure the investment Portfolio within the mandated investment pattern.
- RPFC to monitor the movements in the investment portfolio from the monthly returns being already filed by the Trusts (Annexure A) and in the event of any concern take up with the trustees immediately.

SECTION V. CREATION OF LICENSED PENSION ADMINISTRATORS (LPAs)

5.1 BACKGROUND AND RATIONALE

Since the early 1990s, there is a greater awareness among old economy industries and new sunrise industries (IT, Pharma, etc) about the criticality of the Provident Fund. This has led to a higher willingness among some exempt establishments to be compliant but also enhance the services being provided to the employees by such trusts.

Even then, in the current framework, the role of the trustees is almost always confused with their official role as employees. The objective of the separation of the employer and the trust as intended by the EPFO is not always achieved.

Outsourcing of Trust Administration:

- The concept of outsourcing of administration of Exempt Trust is slowly becoming popular.
- The outsourcer takes care of the mundane day-to-day affairs of the trust with the approval of the trustees on all issues.
- In an ideal situation, the outsourcer ensures compliance for the trust as well as for the establishment and ensures that the members are serviced adequately.
- In the early days of the evolution of the industry, outsourcers were proprietorship concerns who specialized in data processing, paper handling etc.
- However, organized players are now entering this business and making huge investments in technology and processes.
- However, Outsourcing is not still recognized by the EPFO, leading to situations where in during inspections and hearings, the role and functions of the outsourcer are questioned.

Suggestion:

- Formalize the role of the nascent outsourcing industry into a regulated and monitored industry.
- A properly regulated Outsourcing Industry in Provident Fund arena would help EPFO with the monitoring and regulating the Exempt Establishments and Trusts.
- An organized, well provided outsourcer could enhance services to employees and employers using the latest technology and management techniques.

5.2 ROLE & RESPONSIBILITY OF LPAs

LPAs shall focus on exempt trusts with the following broad mandate:

- a) Statutory Compliance/ Regulatory Affairs
- b) Benefits Administration

STATUTORY COMPLIANCE/ REGULATORY AFFAIRS

Such LPAs shall be responsible for compliance with respect to the trust and ensure that the trusts function within the parameters of PF Act and Income Tax Act.

- The Administrator shall be made responsible for 100% compliance by the trusts and establishments managed by them.
- Deviations by the trusts, not within the control of the Administrator shall be reported to EPFO forthwith
- Deviations due to the fault of the administrator shall be monitored and should lead to delicensing/derecognition beyond a fixed tolerance limit.
- LPAs shall be subject to audit/scrutiny by EPFO

LPAs shall be responsible

- a) For the regulatory reporting requirements for each of the exempt trusts administered by them.
- b) For reporting any deviant behavior of the employer or the trust to the EPFO
- c) For the interface between the EPFO and Exempt trusts, by subjecting the trust records and transactions for audit and inspection by EPFO
- d) Ensuring the separation of employer and the trustees
- e) Employer's roll is limited to remitting contributions
- f) Employer does not influence the day to day activities of the trust to detriment of the employees
- g) All employees are treated uniformly by the trust
- h) Employer complies with all the statutory responsibilities

BENEFITS ADMINISTRATION

Administrators shall be laid down strict timelines for transactions processing such as

- a) Settlements
- b) Loan disbursements
- c) Transfers to other trusts/administrators etc

They shall have complete responsibility for all trust accounts, individual statements, all record keeping and the audit of accounts.

Adherence to timelines on transactions processing shall also be reported to the EPFO or any other identified regulator.

5.3 CRITERIA FOR INVESTMENT OFFERING BY LPAs

All LPAs who would like to offer investment services would be required to obtain a Portfolio Management Licenses 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.

All LPAs would be appointed by trustees with responsibilities for:

- a) Identify the investment opportunities available in the market within the regulated pattern.
- b) Invest the moneys of the trust in the regulated pattern
- c) Manage the investment back office for the trusts, tracking the inflows from the investments.

The Administrators shall:

- a) Capture the details of the investments made by the Administrator on behalf of each of the trusts managed by them separately
- b) Ensure that the trusts would meet the mandated pattern of investments
- c) Investments are completed shortest span of time possible
- d) Sale of investments, for the purposes of meeting the liabilities of the trust are made to the benefit of the trust
- e) Ensure that they act in the fiduciary capability of asset managers and act in the interest of the trustees within norms of professionally accepted behavior.

5.4 REGULATORY FRAMEWORK

5.4A Entry Norms

All LPAs shall satisfy certain basic minimum criteria before being allowed to operate. These could be

- a) Minimum Capital, which could be entry level and then may be linked to the corpus size being managed.
- b) IT Infrastructure, a set of minimum Information Technology infrastructure. IT infrastructure is a basic requirement to ensure timely transaction processing and employee servicing

All LPAs that would like to offer investment services would be required to secure a Portfolio Management Licence from SEBI.

5.4B Licensing by EPFO or by an Independent Pension Regulator

Occupational pensions currently cover Provident, Superannuation and Gratuity Funds. A holistic view of the regulatory framework is required but an interim solution is required.

The EPFO take the initiative of licensing LPAs as a part of its initiatives to secure higher compliance and improve the functioning of exempt PF trusts.

As the whole Pension and Provident Fund industry evolves, the dual regulatory and administrative role of EPFO would ideally be separated with the regulatory role handled independently by the EPFO or handed over to an Independent Pension Regulator like the IRDA or SEBI.

5.4C Regulatory Framework

Current Scenario:

- Exempt trusts are currently managed by Trustees who represent the employer and employees. In most cases, employers are represented by senior management personnel and the employees by the trade union representatives.
- The employee representative trustees look at their responsibility almost always from the perspective of securing employee interests and do not bother themselves with the day-to-day administration of the Trust.
- This leaves the employer representative, more often than not the CFO and HR Head, to administer the trusts.
- The day-to-day administration is further delegated to the Finance Department of individual establishments and does not get the attention it deserves except probably for investment of the corpus and settlements/loan disbursement.
- Such a loose arrangement if continued for any length of time leaves whole administration in shambles, this typically happened in old economy industrial establishments exempt during the early periods of PF Act.

The current administrative procedures laid out by EPFO for monitoring such exempt trusts are:

- Monthly returns (Annexure A) which in nutshell captures all the relevant activities of the trust for a month
- However, the time lag of scrutiny of returns by EPFO officials is long and this dilutes effectiveness.
- Inspection of the records of the trust and establishments on an annual basis by the EPFO Officials.
- Visits by Inspectors became an annual ritual. Inspections are conducted in perfunctory manner in most cases do not give any early warning signals.
- Such lack of monitoring and regulation by the EPFO offices led to most of the default situations when such industries failed and members were made to suffer.

Proposed Scenario

The regulatory framework for exempt trusts would be substantially improved by the following three initiatives:

- a) Licensing of LPAs
 - a. The regulatory body shall certify pension administrators who will be liable for compliance and create an additional layer of compliance enforcement
 - b. The LPAs shall be subject to periodic review based on clear and pre-defined criteria
- b) Reporting Requirements
 - a. General Transaction Processing: timelines and accuracy
 - b. Investments on behalf of the Trusts: Timelines of investments, adherence to mandated pattern
 - c. Compliance: status on behalf of each trust, deviations if any, reasons for deviations
- c) Audit and Inspections
 - a. The administrator shall be subject to audit by the regulator every year
 - b. Audit shall focus on
 - i. Status on licensing criteria
 - ii. Accuracy of reporting
 - iii. Compliance status

SECTION VI. VOLUNTARY SELF-REGULATION BY INDIA LIFE

As a precursor to proposed pension reforms, India Life is willing to self regulate itself by submitting reports on its activity relating to Exempt Provident Fund Trusts.

India Life is currently the leading outsourcer in the private sector for companies operating exempt provident funds and offers seamless services for Provident, Superannuation, and Gratuity Funds along with Payroll processing and employee/ employer self-service.

India Life will file returns on the 25th of every month to the with CPFC that will cover:

- a) The name and other details of the Exempt Provident Funds for which the outsourcing services are provided by India Life
- b) The number of employees participating in each of the trusts
- c) The accumulated corpus of each of the trusts as on a particular date
- d) The periodical accretion to the corpus by way of contribution and other earnings for each period of reporting
- e) Compliance reporting with
 - a. Details of fulfilling filing details on behalf of the trusts and employers
 - b. Details of remittance towards inspection charges, EPS/EDLI contributions and charges on behalf of each employer administered by India Life
 - c. Dependence of the trusts with RPFCs for reasons such as non-transfer of funds etc
- f) The additional details of new trusts taken over by India Life during a reporting period
- g) The improvement in compliance status of each trust after take over by India Life

India Life would welcome the EPFO for inspection of individual trusts at our centralized location at Bangalore for administrative convenience and a single window to ensure multi-company and multi-location compliance.