CHAPTER 4

VOLUNTARY PENSION PLANS FOR ORGANIZED & UNORGANIZED SECTOR AND OCCUPATIONAL PENSIONS FOR EMPLOYEES OF PRIVATE SECTOR
The population throughout the world is ageing and the major reasons for this are:

- Increasing Life Expectancy
- Declining Fertility Rates

The government and employers are shifting the risk of longevity to individuals. The demographic changes and volatile economic environment were the major cause forcing the government and employers to shift pensions from Defined Benefit to Defined Contribution.

In addition to this, there were no mandatory income security schemes for the following categories of workers:
Workers in industrial and other establishments earning more than the Rs.6500/- as per the EPF and MP Act, 1952

Self employed persons

Voluntary pension schemes were the best option for such workers. Other workforce such as government employees, private sector employees could top up their retirement savings by opting for such voluntary pension plans.

4.2 SCHEMES OFFERED BY INSURANCE COMPANIES

The demographic trend in India and the limited nature of Government-run and employer based retirement plans forced people to make supplementary savings and investments for retirement. Out of the many retirement solutions, only insurance based solutions could mitigate the three important and correlated risks viz. longevity, health and inflation risk.

Pension plans are thus, offered by insurance companies under IRDA guidelines to aid individuals in building a corpus for old age. At a predetermined age, this corpus was used to buy annuities to generate a regular income, which could be termed as pension. Pension Plans are thus, different from other life insurance plans.
There are two types of pension plans sold in the market a) Traditional (Non-linked) Pension Plans b) ULIP (Linked) Pension Plans.

In such plans the premium payment can be made through recurring payments for a fixed period of time, called regular premium or as a lump sum onetime payment, called single premium. Through both premium payment modes, the premium amount and returns thereon are accumulated and paid out to the policyholder. A part of this is paid as lump sum to meet immediate needs and the balance is used to buy an annuity which provides post retirement income.

Premium payments towards pension plans are eligible for tax deduction U/s 80 CCC. Maturity payouts up to $1/3^{rd}$ of the amount is tax free and annuity payments from the annuities purchased from the remaining $2/3^{rd}$ of the corpus are taxed as income.

The insurer provides several annuity options to the policyholders and the policyholder can choose one of them. Some of these options are listed below:

- Life annuity;
- Life annuity with return of purchase price;
• Life annuity guaranteed for 5/10/15 years and for life thereafter;
• Joint life, last survivor with return of purchase price;
• Joint life, last survivor without return of purchase price;
• Annuity increasing at a simple rate of 1%, 2% or 3% p.a.

These plans provide either immediate\(^1\) or deferred\(^2\) pension to the retiree.

In unit linked pension products which had their roots in unit trusts (Mutual Fund), the premium was used to buy units of different funds like debt, equity and balanced as indicated by the policyholder. Initially the premium is used to buy units from high risk funds, say equity, and progressively the shift is made to an asset class with lower risk, ultimately coming down to 100% debt by vesting date. Since equity is high risk high return, over a long term it provides better returns.

\(^1\) An annuity contract that is purchased with a single lump-sum payment and in exchange, pays a guaranteed income that starts almost immediately. – definition by Investopedia

\(^2\) A type of annuity contract that delays payments of income, installments or a lump sum until the investor elects to receive them. This type of annuity has two main phases, the savings phase in which you invest money into the account, and the income phase in which the plan is converted into an annuity and payments are received – definition by Investopedia
The charges under ULIP products are different than those under traditional products and are deducted directly from the available units. The charges under ULIPs are as follows:

- Fund Management Charge
- Policy Administration Charges
- Allocation Charges
- Mortality Charges
- Fund Switching Charges
- Revision / Alteration Charges
- Miscellaneous Charges
- Top-Ups Charges

4.2.1 IRDA GUIDELINES

The life insurance industry took a dramatic turn due to Insurance Regulatory and Development Authority's (IRDA) new guidelines\(^3\) to provide a minimum guarantee of 4.5% annual appreciation of capital value. This move affected the unit linked policies especially. The insurance companies and other industry experts expressed their dissatisfaction and argued that a minimum guarantee was not possible since there were no bonds of this tenure.

\(^3\) *Insurance Regulatory and Development Authority’s new guidelines on Pension – September 2010*
that the insurance companies could invest in. Coupled with this, the revised charging structure forced insurers\(^4\) to cease offering pension products. Due to this, the first year premium for the industry fell to 17% in the period between April and December 2011. Even the state-owned Life Insurance Corporation of India saw a fall in its first year premium. On the other hand the policyholders cheered the favourable norms. Thus the Unit linked products have become less costly and more affordable for customers. The new pension guidelines, September 2010 circulated by IRDA ensured that the maturity benefits will have a guarantee embedded within the product.

A year later, on 8.11.2011 IRDA withdrew its earlier guidelines and came up with a new one\(^5\). According to the new guidelines:

- "The IRDA has withdrawn 4.5% guaranteed returns"
- "There must be some guarantee element with the plan either by way of offering positive returns on premium paid or assured maturity benefit.
- "Same insurer will provide annuity services."

\(^4\)Financial Express 26.1.2011  
\(^5\) Insurance Regulatory and Development Authority’s new guidelines on pension 8.11.11
That means the IRDA is asking insurers to protect the capital invested by the policyholders. This was to ensure that there would not be any loss in nominal terms at least.

As we have seen, the first year premium plummeted post the September 2010 guidelines of IRDA and affected the entire insurance industry. In India, longevity is increasing, social security is low and the erosion of the joint family system is offering huge opportunities for the pension products market. This should encourage insurers to provide customers with a wider choice in pension products.

Again on 5.1.2012, the IRDA came up with yet another revision which stated as follows:

- “The insurer shall guarantee either a non-zero rate of returns on premiums paid from the date of payment to the date of vesting or an absolute amount (which shall result in a non-zero returns), which means it ensures that capital amount is not eroded. In both cases, this shall be disclosed at the time of purchase of the policy.

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6Insurance Regulatory and Development Authority’s revision 5.1.2012 on pension
• In the event of the death of a policyholder during the term of the contract, the successor to the policyholder shall be entitled to receive a sum equal to the premiums paid at the guaranteed rate of return as specified in (a) above.

• If the insurance product is on a ULIP platform, the surrender value shall be the higher of fund value and premium accumulation at a guaranteed rate on the date of surrender less the discontinuance charges as per the guidelines of IRDA\(^7\). In all non-linked products, the surrender value shall be in conformity with the provision of the Insurance Act.”

The IRDA rejected all pension products filed under the guidelines issued in November 2011\(^8\). The surrender value norm associated with the filed products offered either 50% of the fund value or accumulated premiums (whichever was higher). Accordingly, the IRDA asked insurers to refile the products with a surrender value based on the fund value or the premium accumulated at a guaranteed rate, whichever was higher.

Fulfilling the above provisions was found difficult for insurers who are required to make long term investments. Generally a pension plan is long term in nature. Accordingly, the insurance

\(^7\)(Treatment of Discontinued Linked Insurance Polices) Regulations, 2010
\(^8\)IRDA Regulation reject new product, 19.1.2012 – Business standard
company prudently invests in long term securities to guarantee a rate of return. However, if somebody wants to surrender the policy before maturity and the insurer has to pay the same rate of return, it would restrict investments, which would make the product unattractive.

The IRDA decided to take some action against agents for pushing life insurance policies especially ULIPs, irrespective of whether they match the needs of a customer or not. Customers are now expected to get a good service from agents throughout the policy term. This was a significant customer-centric move by the IRDA to curb mis-selling of policies. Policyholders were allowed to revive discontinued ULIPs. Until then if a person missed a premium, his policy would lapse. Now, he can revive policy within a maximum of two years of last premium paid, provided it falls within the mandated lock-in period of five years.

An actuary commented that “this would force insurance companies to invest in short-term cash-type instruments, which is not an ideal asset allocation strategy for managing funds of pension products. This would not be beneficial to customers, given the long term nature of these products”.
As per the guidelines the annuity will be bought from the same insurers. The annuity rates will be decided at the time of vesting of pension. If another insurer offers better annuity rates, the annuitant cannot do anything but to accept it. As per the Exempt-Exempt-Tax tax regime, the biggest snag is - annuity in India is taxable. At the time of vesting, 1/3rd of corpus can be withdrawn lump sum without tax and remaining corpus will have to convert into annuity. In this situation, if a customer does not have a wide choice of buying an annuity, it becomes an undesirable situation for the customer. Requirement of buying the annuity from the same insurer diminishes the flexibility for customers.

This guideline is to de-risk LIC from the associated risk of handling almost 99% annuities. The efforts of the regulator were laudable.

As per the statement made by IRDA Chairman in his interview9 “the private life insurance companies shift the responsibility of providing annuity to LIC, slyly directing the consumer to LIC for annuities”. This results in concentration of great systemic risk to LIC which is undesirable from the LIC

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9*The Hindu Business Line (dated 9.2.2012).*
perspective. Every life insurance company must provide annuity when it is selling the pension product.

### 4.2.2 INVESTMENT AS PER THE IRDA INVESTMENT REGULATIONS

Investment Pattern for Pension and General Annuity business of the life insurers\(^{10}\) is given in Table 6

**Table 6: INVESTMENT PATTERN FOR PENSION BUSINESS, GENERAL ANNUITY FUND OF THE LIFE INSURERS**

<table>
<thead>
<tr>
<th>Sr.No.</th>
<th>Type of Investment</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Government Securities, being not less than</td>
<td>20%</td>
</tr>
<tr>
<td>2</td>
<td>Government securities or other approved securities (inclusive [i] above, being not less than)</td>
<td>40%</td>
</tr>
<tr>
<td>3</td>
<td>Balance to be invested in approved investments as specified in Schedule 1 and to be governed by Exposure / Prudential norms specified in Regulation 5</td>
<td>Not exceeding 60%</td>
</tr>
</tbody>
</table>

*Note: For the purpose of this sub-regulation no unapproved investments shall be made. This investment pattern is for post vesting period. During the accumulation phase the investment pattern is similar to that of any other life insurance product.*

*Source – IRDA Investment Regulations*

Unit linked Life Insurance Business- “Every insurer shall invest and at all times keep invested his segregated fund of unit linked life insurance business as per pattern of investment offered to and approved by the policy holders. Unit linked policies may only be

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\(^{10}\) *Investment Pattern for Pension and General Annuity business of the life insurers – IRDA Investment Regulations*
offered where the units are linked to categories of assets which are both marketable and easily realizable. However the total investment in another category of investment shall at no time exceed 25% of the fund.”

4.2.3 TAX IMPLICATIONS

In a pension product there are three phases with a tax implication. These are:

- At the contribution stage
- At the accumulation stage
- At the payout stage

The Government plays a significant role in encouraging investors to invest in pensions by offering them tax incentives for building up pension. In India the tax model broadly followed is Exempt-Exempt–Tax i.e. Tax exemptions on contribution and accumulation phase and tax at payout phase. According to the current reformation phase of pension market in India, the new guidelines of the DTC, which is definitely favourable to policy holders, would refurbish the pension market, though life insurers are sceptical about the revival of pension markets.
According to the data released by the Life Insurance Council\textsuperscript{11}, the total business premium collected by insurers has declined by 21\% year-on-year to Rs 49,046 crores from Rs 62,362 crores in 2011. The fall in new business is due to low sale of ULIP policies and a particularly negligible sale in pension products.

Before September 2010, the individual pension segment contributed around 32\% of the premium collection which fell to 28\% in 2011. Total number of policies sold in the pension segment also came down to 0.06 million from 3.35 million. This was mainly due to the changed guidelines of IRDA, specifically scrapped out an assured 4.5\% guarantee wherein growth was expected soon in the pension market.

\textbf{4.3 PUBLIC PROVIDENT FUND (PPF)}

The Public Provident Fund Scheme was started by Government of India, The Ministry of Finance in June 1968. The main objective of the scheme was to encourage people to save, to build a retirement corpus, specifically the private sector employees as well as self-employed individuals who were excluded from

\textsuperscript{11}Life Insurance Council – 2011-12- www.lifeinscouncil.org
existing social security schemes. It is a defined contribution plan that mandates annuitization and supports flexible contributions. It is also a powerful instrument for long term wealth creation. The scheme is for 15 years. A PPF scheme is operated through the Post Office and the State Bank of India or any of its subsidiaries. Most public sector banks accept PPF contributions and an account can be opened by an individual or a minor through a guardian. Joint accounts are not permissible. Since its commencement, those who are contributing to the General Provident Fund (GPF) account can also open a PPF account. Non Resident Indians are not allowed to open an account under the PPF scheme.

4.3.1 CONTRIBUTION

According to the PPF scheme 1968, a member can deposit minimum Rs. 500/-and maximum Rs. 1 lakh in a financial year. One deposit with a minimum amount of Rs. 500/- is mandatory. This low contribution scheme attracted people from low income groups who could think of saving for retirement under the safe umbrella of the Government with good investment returns. Multiple deposits in a year were allowed which made it easier for middle class as well as low income groups to create wealth.
4.3.2 INTEREST RATE

The interest rate is notified by the Ministry of Finance, Government of India at the beginning of each year, this being an administered interest rate product. The present rate of interest as per the notification of the Ministry of Finance dated 25.11.2011 is 8.8% compounded annually w.e.f. 1.4.2012. Unlike the National Savings Certificate, the interest rate for PPF is not fixed. It can vary every year depending upon the economic conditions as decided by the Government of India. This is one of the few administered interest rate scheme now remaining.

4.3.3 WITHDRAWALS

PPF is a long term investment. However, for contingencies, this scheme allows withdrawals. It has an initial lock-in period is 5 years. Therefore, the account holder can withdraw after the 5th year subject to a limit of 50% of the amount in the account at the end of 4th year. Thereafter one withdrawal every year was permissible. The subscriber can continue the account on expiry of 15 years for a further block period of 5 years. Partial withdrawal was allowed up

\(^{12}\text{Notification of Ministry of Finance dated 25.11.2011}\)
to 60% of the balance to the credit at the commencement of the extended period.

4.3.4 INCOME TAX

The deposits in PPF qualify for tax benefits under section 88 of Income Tax Act and interest earnings as well as the accumulated balance withdrawn from the fund are tax free. Since the PPF is EEE (exemption on investing – exemption during accrual – exemption on withdrawal) tax regime that means entire investment in PPF is tax free. The deposits are exempt from wealth tax also. Therefore, PPF has come across as the most preferred plan among the self employed, being a tax-saving device.

4.3.5 BENEFITS

- The PPF is a government scheme. Thus it is amongst the safest instruments to invest in.
- The rate of interest earned / declared so far has been between 8% and 15 percent a year.
- It even helps the lower income group to build up a corpus because minimum investment is Rs. 500/-.
- Apart from the stipulated lock-in period, a person can withdraw money in emergencies as per the rules.
• Loans up to 25% of balance at the end of first financial year are available. The rate of interest on the loan is 2% p.a.\textsuperscript{13} as per revised office memo of The Ministry of Finance.

• PPF is a multiple tax benefit scheme which enjoys EEE tax benefits. That means the entire investment in PPF is tax free, subject to the provision of Section 80 C.

• If a person doesn’t need the funds at the time of maturity (i.e. after 15 years) he can opt to continue the PPF. That means extension is possible.

• Investment flexibility – A person can invest minimum Rs. 500/- p.a. to maximum Rs. 1 lakh p.a. This year the government increased the limit from Rs. 70,000/- to Rs. 1 lakh\textsuperscript{14} as per the notification displayed on RBI’s website.

4.3.6 DISADVANTAGE OF PPF

• Long lock-in period – A period of 15 years is pretty long in terms of a fixed return instrument. Investors find it beneficial to invest in equity for more than 10 years because the risk from equity becomes almost ZERO in long run investment.

\textsuperscript{13}PPF rate of interest on loan - as per revised office memo of Ministry of Finance dated 11.11.2011
\textsuperscript{14}PPF - as per the notification dated 25.11.2012 - www.rbi.org.in
• Interest rate keeps changing – The interest rate of PPF always floats according to Government policy. It has drastically reduced from 17% p.a. to 12%, 10%, 9.5% and today it is 8.8% only.

• Lack of Liquidity – Investor cannot withdraw money before 5th year of investment. This is considerably a long lock-in period. It is not as easy as selling some shares or mutual fund units. A person can take a loan maximum of only 25% of the balance at the end of the financial year.

• A PPF cannot be opened in joint names. A person can have only one PPF account at given time.

4.4 PENSION SCHEMES OFFERED BY OTHER FINANCIAL INSTITUTIONS

Financial institutions such as the Unit Trust of India, Templeton offer pension plans that are funded like ULIP plans. These funds offer regular payments in the form of systematic withdrawal. A subscriber can also buy life annuity from a life insurer.

These products are eligible for income tax rebate at 20% for contributions upto Rs. 10,000/- per year, under section 80 CCC (1)
of the Income Tax Act, 1961. However, the pension payments are taxed as income.

The Securities and Exchange Board of India (SEBI) regulates such pension plans.

4.5 **VARISHTHA PENSION BIMA YOJANA**

The Varishtha Pension Bima Yojana was announced by the Finance Minister in the 2003-04 budgets\(^\text{15}\). The plan, administered by the Life Insurance Corporation of India, was in response to the ongoing process of developing a pension system for the elderly in the unorganised sector of the economy. Any person in the age group of 55-79 years was eligible to participate in the scheme. A one-time deposit was to be made with the LIC. The minimum and maximum deposit amounts for the scheme were fixed at Rs. 33,395/- and Rs. 2,77,490/- respectively.

The scheme had a rider, that only one person in a family could avail of the benefit of the scheme. The subscriber was entitled to a 9%\(^\text{16}\) assured return on the amount deposited. The corpus was essentially treated as a fixed deposit and the 9% return on this

\(^{15}\)Department of Financial Services, Ministry of Finance, Government of India  
\(^{16}\)Ministry of Labour & Employment website, Government of India
amount was termed as 'pension' under the scheme. The minimum and the maximum monthly returns on the scheme were fixed at Rs. 250/- and Rs. 2000/- respectively. The monthly pension ceases on the death of the subscriber, and the initial lump sum deposit is refunded either to the spouse or to the nominee.

LIC invested the corpus built in a well-diversified portfolio and paid the assured 9% interest. The overall cost of the scheme worked out to 9.38% annually – 9% assured return to the pensioners and administrative cost of 0.38%. While LIC earned a return of 6-7% from its investments from the fund, the Government substituted the remaining amount. The initial budgetary subsidy to LIC for the year 2003-04 was fixed at Rs. 3 million, which was later revised to Rs. 4.5 million in view of the encouraging response. The scheme was withdrawn by the Government in the year 2004-05.

4.6 SOCIAL SECURITY SCHEMES FOR WORKERS OF THE UNORGANIZED SECTOR

In India, the term social security encompasses social insurance, social assistance, social protection and social safety. The Government of India designed various models of providing social
security to the workers of unorganized sector. They can be classified as under:

a) Centrally Funded Social Assistance Programme

b) Social Insurance Scheme

c) Social assistance through welfare funds of Central and State Governments

d) Public Initiative

4.6.1 CENTRALLY FUNDED SOCIAL ASSISTANCE PROGRAMME

The Centrally Funded Social Assistance Programme includes employment oriented poverty alleviation programmes as follows:

- Swarnjayanti Gram Swarojgar Yojana,
- Jawahar Gram Samridhi Yojana,
- Employment Assurance Scheme
- National Social Assistance Programme (NSAP) comprising old age pension, family benefit and maternity benefits to address the social security needs of the people below poverty line.
4.6.2 SOCIAL INSURANCE SCHEME

The Social Insurance Schemes include several schemes launched by the Central and the State Governments for the benefit of weaker sections through the Life Insurance Corporation of India and the General Insurance Corporation of India.

‘Janshree Bima Yojana’, a group insurance scheme, covers natural/accidental death, partial or total permanent disability due to accident. People below poverty line and marginally above are eligible to join the Scheme.

Another group insurance scheme for agriculture landless labour is the ‘Krishi Shramik Samajik Suraksha Yojana-2001 launched in July, 2001. It provides for pension and insurance besides providing money back. The beneficiary’s contribution was of Re.1 per day while the Government contributes Rs. 2/- per day.

Several public institutions and agencies also impart various kinds of social security benefits to selected groups of workers. Among these Self Employed Women’s Association (SEWA) was found to have made significant achievement in promoting social security through the formation of cooperatives.

The Scheme provided for three basic necessities to the workers in the unorganized sector (i) old-age pension, (ii) personal accidental insurance and (iii) medical insurance. The scheme is available for workers drawing pay/wages/income not more than Rs. 6500/- p.m. The details of benefits are as under:

i. Pension Scheme: A minimum pension @ Rs.500/- per month at the age of 60 years or permanent/total disablement and family pension in case of the death of the workers with a provision for enhanced or reduced pension based on the contribution;

ii. Personal Accidental Insurance: An accidental insurance cover of Rs. One lakh; and

iii. Medical Insurance: Coverage under the Universal Health Insurance Scheme (UHIS) for a family of five including member. The Scheme provides for reimbursement of hospitalization expenses upto Rs. 30,000/- in a year and in case a member is hospitalized due to accident/illness, a compensation of Rs. 50/- per day upto a maximum of 15 days
after initial period of three days and also coverage of death of the worker due to accident (Rs. 25,000/-).

To avail benefits under this entire scheme, a single contribution @ Rs. 50/- p.m. from the workers joining the scheme in the age group of 18-35 years and Rs. 100/- p.m. from the workers in the age group of 36-50 years. The contribution from the employers wherever identifiable in both the categories works out to @ Rs. 100/- p.m. The Government’s contribution is @ 1.16% of the monthly wages of the workers based on the national minimum floor level wage as notified by the central Government from time to time.

The Scheme was being implemented through the Employees Provident Fund Organization (EPFO) having around 260 offices in the country and which will provide single window service to the workers for all the three components of the Scheme. As far as practical and feasible, the infrastructure of the Employees State Insurance Corporation (ESIC) will be used to provide benefits under Universal Health Insurance Scheme (UHIS). The Workers Facilitation Centers have been set up to assist the workers and liaison with other agencies like State Labour Machinery and also the
Panchayati Raj Institutions, Self-Help Groups and NGOs, etc. for smooth implementation of the Scheme\textsuperscript{17}.

4.7 MANDATED PROVISIONS FOR ORGANIZED SECTOR

The organized sector includes primarily those establishments which were covered by the Factories Act 1948, the Shops and Commercial Establishments Act 1946, etc. This sector already had a structure through which social security benefits were extended to workers covered under these legislations. The following schemes were amongst the major social security programmes formulated for the organized working class of India under the aegis of the EPFO:

- Employees' Provident Funds Scheme, 1952,
- Employees Deposit Linked Insurance Scheme, 1976 and
- Employees' Pension Scheme, 1995

The Table-7 below presents an overview\textsuperscript{18} of the three schemes:

\textsuperscript{17}Labour Ministry Website – Article - Unorganized Sector in India
\textsuperscript{18}EPFO Annual Report – 2010-11
Table 7: OVERVIEW OF EPFO SCHEMES

<table>
<thead>
<tr>
<th>Benefits:</th>
<th>Employees' Provident Fund Scheme, 1952</th>
<th>Employees' Pension Scheme, 1995</th>
<th>Employees’ Deposit Linked Insurance Scheme, 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefits:</td>
<td>Accumulation plus interest upon retirement, resignation, death Partial withdrawals allowed for specific expenses such as house construction, higher education, marriage, illness</td>
<td>Monthly benefits for superannuation/retirement, disability, survivor, widow(er), children Amount of pension based on average salary during the preceding 12 months from the date of exit and total years of employment Minimum pension on disablement Past service benefit to participants of erstwhile Family Pension Scheme, 1971.</td>
<td>The benefit provided in case of death of an employee who was member of the scheme at the time of the death, the family will get 20 times of the average wages of the last 12 months of the member. According to the revised scheme, maximum benefits under the scheme will now be Rs.1,30,000/-, as the wage ceiling upto which contribution can be paid under the scheme is Rs.6500/-</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Contributions:</th>
<th>Employees' Provident Fund Scheme, 1952</th>
<th>Employees' Pension Scheme, 1995</th>
<th>Employees’ Deposit Linked Insurance Scheme, 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer (%) on wages</td>
<td>3.67% - 182 industries 1.67% - 5 industries</td>
<td>8.33%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Employee (%)</td>
<td>12% - 182 industries 10% - 5 industries</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Government (%)</td>
<td>Nil</td>
<td>1.16%</td>
<td>Nil</td>
</tr>
<tr>
<td>Administrative Charges to be paid by the Employer of Un-exempted Establishments (%)</td>
<td>1.10%</td>
<td>Till 5.1.2007 @ of 16% paid out of the EPS Fund and rest from EPF Administration Fund. w.e.f 6.1.2007 to be met fully from EPF.</td>
<td>0.01%</td>
</tr>
<tr>
<td>Inspection Charges to be paid by the Employer of Exempted Establishments (%)</td>
<td>0.18%</td>
<td>Not Applicable</td>
<td>0.005%</td>
</tr>
</tbody>
</table>

Source: EPFO Annual Report 2011
4.7.1 EMPLOYEE PROVIDENT FUND SCHEME – 1952

According to the Annual Report of the EPFO 2010-11, 187 industries and classes of establishments notified by the Government were covered by the Employees Provident Fund & Miscellaneous Provisions Act, 1952 and which employed 20 or more persons are mandated to subscribe to the Employees Provident Fund Scheme (EPF), 1952, the Employees’ Pension Scheme (EPS) 1995, and the Employees Deposit Linked Insurance Scheme (EDLI) 1976. These schemes are managed by the Employees Provident Fund Organization (EPFO). The Coal Mines PF was managed by The Ministry of Coal, the Seamen’s Provident Fund was managed by The Ministry of Surface Transport, the Assam Tea Plantation Provident Fund was managed by the Ministry of Agriculture and the Jammu & Kashmir Provident Fund was managed by the State Government.

Provident Fund is one of the main and most popular employee benefit scheme for the organized sector in India. The EPF, 1952, the EPS, 1995 and the EDLI, 1976 schemes are a combination of Defined Benefit (DB) and Defined Contribution (DC) schemes. The EPF is a DC and the EPS is a DB scheme. The replacement rate is 50% of the terminal wage, the average of the last twelve month’s salary. The significant difference here is that they
are not linked to inflation. Since it was a DC plan under which accumulation are paid to workers as a lump sum on retirement.

4.7.1.1 CONTRIBUTIONS

Both the employers and the employees are mandated to make equal contribution of 12% of the basic salary. The establishments which are suffering from economic stress or declared as sick are eligible to contribute 10% of basic salary. Equal contributions are payable monthly. The employer was required to deposit both the shares of contribution directly, including contractor’s employee, if any. Out of the employer’s contribution of 10% to 12%, 8.33% is diverted towards the EPS and the balance 3.67% along with the full employee’s share of contribution was pooled into the provident fund account of the employee. The total contribution towards provident fund worked to nearly 25%. As per the OASIS report a contribution of over 25% towards retirement benefits in India is among the highest in the world. High contribution rates leave little or no surplus income for savings for other contingencies by employees.

4.7.1.2 BENEFITS

The EPFO invests the accumulated corpus as per the investment guidelines prescribed by the Government. Interest was
declared every year by the EPFO Board of Trustees and was directly credited to the members account. Over the last decade, the PF has announced a 12% nominal annual return to their members. The interest rates from the year 1990-91 till 2011-12 are exhibited in the Table-8.

Table 8: EPF RATE OF INTEREST FROM 1990-91

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate of Interest</th>
<th>Year</th>
<th>Rate of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>12%</td>
<td>2001-02</td>
<td>9.5%</td>
</tr>
<tr>
<td>1991-92</td>
<td>12%</td>
<td>2002-03</td>
<td>9.5%</td>
</tr>
<tr>
<td>1992-93</td>
<td>12%</td>
<td>2003-04</td>
<td>9.5%</td>
</tr>
<tr>
<td>1993-94</td>
<td>12%*</td>
<td>2004-05</td>
<td>9.5%@</td>
</tr>
<tr>
<td>1994-95</td>
<td>12%*</td>
<td>2005-06</td>
<td>8.5%</td>
</tr>
<tr>
<td>1995-96</td>
<td>12%*</td>
<td>2006-07</td>
<td>8.5%</td>
</tr>
<tr>
<td>1996-97</td>
<td>12%*</td>
<td>2007-08</td>
<td>8.5%</td>
</tr>
<tr>
<td>1997-98</td>
<td>12%*</td>
<td>2008-09</td>
<td>8.5%</td>
</tr>
<tr>
<td>1998-99</td>
<td>12%*</td>
<td>2009-10</td>
<td>8.5%</td>
</tr>
<tr>
<td>1999-00</td>
<td>12%*</td>
<td>2010-11</td>
<td>9.5%</td>
</tr>
<tr>
<td>2000-01</td>
<td>125%*</td>
<td>2011-12</td>
<td>8.25%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012-13</td>
<td>8.50%</td>
</tr>
</tbody>
</table>

(*)12% (April-June,2001) on monthly running balance.(@ 9% Interest plus 0.5%) golden Jubilee bonus interest). Source: EPFO Annual Report 2010-11

4.7.1.3 WITHDRAWALS

Employees are allowed to make premature partial withdrawals for specified purposes such as construction of house, marriage of self and family members, repayment of housing loan, illness, temporary unemployment, etc. Employees are also permitted...
to withdraw 90% of the balance in their account in the year preceding their retirement. In case of death of the member, the amount is paid to the nominee.

4.7.1.4 TAX

In tax parlance, the status of EPF is EEE (Exempt- Exempt-Exempt). This means that EPF is tax-free at the time of investment, during the accumulation phase and at the time of withdrawal or maturity. However, an employee needs to stay invested in EPF for at least five years to enjoy the tax-free status at the time of withdrawal.

According to its 2010-11 Annual Report, the EPFO covers 6,60,546 establishments and has 6,15,88,670 subscribers20. Since most subscribers have 4-5 accounts, the actual number covered by the EPFO could range between 4-5 crores, The EPFO had a corpus of Rs. 4,66,370.43 crore as on 31.3.2011. Category-wise corpus of the EPFO investment along with growth21 is depicted in Table-9:

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20 As per the Annual Report of EPFO for the year 2010-11

21 EPFO – Investment Corpus - Source : EPFO Annual Report 2010-11
### Table 9: EPFO INVESTMENT CORPUS

<table>
<thead>
<tr>
<th>Year</th>
<th>EPF</th>
<th>EPS</th>
<th>EDLI</th>
<th>Total</th>
<th>Growth %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010-11</td>
<td>3,14,981.95</td>
<td>1,42,050.82</td>
<td>9,337.66</td>
<td>4,66,370.43</td>
<td>16.44%</td>
</tr>
<tr>
<td>2009-10</td>
<td>2,68,565.00</td>
<td>1,23,790.43</td>
<td>8,171.76</td>
<td>4,00,527.19</td>
<td>14.82%</td>
</tr>
<tr>
<td>2008-09</td>
<td>2,33,105.41</td>
<td>1,08,578.28</td>
<td>7,155.33</td>
<td>3,48,839.02</td>
<td>-</td>
</tr>
</tbody>
</table>

*Source: EPFO Annual Report 2010-11*

If an employee’s salary is higher than Rs. 6,500/- and they can opt to pay for the EPS at the full rate (that is at 8.33% of the employer’s contribution and not limited to Rs. 541/-). From the day their salary exceeds Rs. 6,500/- employee can get half the average of the last 12 months salary as a pension. Under this scheme, after 33 years of service, the employee is eligible for a pension of Rs. 3,250/- per month till his/her death.

#### 4.7.1.5 LACUNA

The drawbacks of the scheme are mentioned below:

- Due to premature and partial withdrawal the EPFO cannot build a good corpus.
• Due to stringent investment guidelines\textsuperscript{22}, the fund yields poor rate of returns. The category-wise investment as per the guidelines is exhibited in Table – 10.

• Due to improper record keeping, duplicate accounts are created with the EPFO.

**Table 10: EPFO CATEGORY-WISE INVESTMENT AS ON 31.3.2011**

<table>
<thead>
<tr>
<th>Category</th>
<th>EPF (Rs. in Crores)</th>
<th>EPS (Rs. in Crores)</th>
<th>EDLI (Rs. in Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Government Securities</td>
<td>47554.01</td>
<td>34099.50</td>
<td>1296.87</td>
</tr>
<tr>
<td>a) State Government</td>
<td>30904.75</td>
<td>16392.71</td>
<td>813.99</td>
</tr>
<tr>
<td>b) Government guaranteed securities</td>
<td>2406.64</td>
<td>2617.40</td>
<td>109.10</td>
</tr>
<tr>
<td>Special Deposit Scheme</td>
<td>52628.82</td>
<td>1,400.52</td>
<td>2.50</td>
</tr>
<tr>
<td>Public Sector Financial Institutions/Undertakings (including Private Sector bonds/securities)</td>
<td>67569.79</td>
<td>36355.28</td>
<td>1695.17</td>
</tr>
<tr>
<td>Public Account</td>
<td>51185.41</td>
<td>5420.03</td>
<td></td>
</tr>
</tbody>
</table>

*Source: EPFO Annual Report 2010-11*

4.7.2 **EMPLOYEE PENSION SCHEME (EPS) 1995**

The EPS is a defined benefit plan that pays monthly pension to members for life. The Employees Family Pension Scheme (EFPS), 1971 was in operation since April 1971. Since this scheme was provided with limited pensionary coverage to the employees, a

\textsuperscript{22}Category wise investment - Source : EPFO Annual Report 2010-11
need was felt to introduce EPS, 1995 as an extension of EFPS with enhanced contributions. The scheme is mandatory to all members of EFPS. The scheme provides for an annuity to retiring employees, besides the survivor benefits being paid under the EPS. Under the EPS, members must have completed a minimum of 10 years of service and must be at least 58 years old. On cessation from employment before completing 58 years a member could opt for early pension. Such early pension can be availed only after completing 50 years of age and it was subject to discounting factor at the rate of 4% (w.e.f. 26.9.2008) for every year falling short of 58 years. The details of enrollment members\(^{23}\) are given in Table-11 and details of EPS corpus\(^{24}\) and number of pensioners are given in Table-12:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>As on 31.3.2009</td>
<td>4,47,82,788</td>
</tr>
<tr>
<td>As on 31.3.2010</td>
<td>5,93,85,325</td>
</tr>
<tr>
<td>As on 31.3.2011</td>
<td>5,51,20,693</td>
</tr>
</tbody>
</table>

*Source: EPFO Annual Report 2010-11*

\(^{23}\)Details of Enrolment of Members - Source: EPFO Annual Report 2010-11 (2009 to 2011)

\(^{24}\)Details of EPS Corpus - Source: EPFO Annual Report 2010-11
Table 12: EPS CORPUS AND NUMBER OF PENSIONERS AS ON 31.3.2011

<table>
<thead>
<tr>
<th>Year</th>
<th>Corpus in Cr.</th>
<th>No. of Pensioners</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>1,08,578.28</td>
<td>3,24,6,131</td>
</tr>
<tr>
<td>2009-10</td>
<td>1,23,790.43</td>
<td>3,51,0,006</td>
</tr>
<tr>
<td>2010-11</td>
<td>1,42,050.82</td>
<td>3,52,5,971</td>
</tr>
</tbody>
</table>

Source: EPFO Annual Report 2010-11

4.7.2.1 CONTRIBUTIONS

No separate contribution was to be made by employees. Out of the 10%-12% of the employee’s contribution to the Provident Fund, 8.33% was diverted towards this scheme. In addition 1.16% of employee’s wages was contributed by Central Government. The wages for contribution purpose are restricted to a maximum of Rs. 6,500/-.

4.7.2.2 BENEFITS

The amount of the pension benefit was based on the employee’s average salary during the final year of employment and the total number of years of employment. It was found to be up to a maximum of 50% to the average of the last 12 month’s salary. The scheme provided following benefits:
• Pension payment for life on retirement / superannuation.
• Pension payment for life in the event of the employee becoming an invalid while in service.
• The scheme provides a commutation facility also.
• In case of death of the employee; there was provision for pension payment to the spouse or other eligible family member. Two children are eligible to get regular income till they attain age 25.

The pensionable salary (Basic Pay plus DA) was the worker’s average salary in the 12 months preceding retirement. The maximum pensionable salary is capped at Rs. 6,500/- per month. Member’s pension was calculated at the rate of 1/70th of pensionable salary for each year of service subject to maximum of 50%. Pensionable salary was the salary drawn during the contributory period of service in the span of 12 months preceding the date of exit from the membership of EPF.

In case of a new entrant the amount of monthly superannuation pension was computed in accordance with the following factors:

Monthly Member’s Pension =
(Pensionable salary x Pensionable service) / 70
4.7.2.3 EPS UPDATES

The number of EPS members\textsuperscript{25} for the year 2010-11 is 5,51,20,693.

A pensioners forum demanded\textsuperscript{26} that pension under the employees' pension scheme should be increased to a minimum of Rs. 5,000/- from the present Rs. 300/- per month. The present pension fixed under the scheme four decades back was not even sufficient to meet one square of meal taking into consideration the present cost of living.

A proposal to guarantee a minimum pension of Rs. 1,000/- p.m. to all workers covered under the EPFO may had to be shelved because nobody was willing to bear the extra costs. Neither the Government nor the employers or employees were willing to shell out the additional contribution of 0.63% of basic pay that would be required to fund the guaranteed pension.

The Central Board of Trustees, the top policy making body of the fund, was to consider the proposal on December 23, 2011. Of the 35 lakhs pensioners under the EPS, 1995 only about 7.2 lakhs

\textsuperscript{25}Total number of EPS members - Source : EPFO Annual Report 2010-11
\textsuperscript{26}Pensioners’ Forum demands - Source – Times of India 30.11.2010
currently got pension of more than Rs. 1,000/- p.m. about 15 lakhs people got pension between Rs. 500/- – Rs. 1,000/-, while about 12.8 lakhs pensioners got less than Rs. 500/-. An Expert Committee appointed by the Centre in 2009 to suggest changes in the pension scheme, had made a host of suggestions including fixing a minimum pension of Rs.1,000/-. According to the Committee Report, it would require a contribution of 0.63% of basic wages over and above the current contribution of 8.33% by employers and 1.16% by the Centre27.

4.7.3 **EMPLOYEES DEPOSIT LINKED INSURANCE SCHEME (EDLI) 1976**

Employees' Deposit Linked Insurance Scheme, 1976 came into force from 1st August, 1976. The scheme was supported by a nominal contribution from the employers. No contribution was payable by the employee for availing the insurance cover.

Employees' Deposit Linked Insurance Scheme, 1976 is applicable to all factories/establishments to which the EPF &MP

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27 _Expert Committee Appointed by Central Board of Trustee, EPFO Source Economic Times 13.12.2011 – Amiti Sen._
Act, 1952 applies. All the employees who are members of the provident fund are members of this Scheme.

4.7.3.1 CONTRIBUTIONS

While the employee members were not required to contribute to the Insurance Fund, the employers were required to pay contributions to the Insurance Fund at the rate of 0.5% of pay i.e. basic wages, dearness allowance including cash value of food concession and retaining allowance, if any. The employees of covered establishments granted exemption under the EDLI Scheme were required to pay the inspection charges @ 0.005% of basic wage, dearness allowance including cash value of food concession and retaining allowance, if any with effect from 15th January 1989 subject to a minimum of Rs.1 per month.

4.7.3.2 BENEFITS

The benefits under the EDLI scheme were revised during the year 2010-11. Under the revised scheme, the benefit provided in case of death of an employee who was member of the scheme at the time of the death, the family would get 20 times of the average wages of the last 12 months of the member. According to the revised scheme, maximum benefits under the scheme would now be Rs.
1,30,000/-, as the wage ceiling upto which contribution could be paid under the scheme was Rs. 6500/-.

The total investment of EDLI accumulations in respect of un-exempted establishments as on 31.03.2011\(^{28}\) amounted to Rs. 9,337.66 crores

4.8 GRATUITY

According to the Payment of Gratuities Act 1972, gratuity is payable lump sum to salaried workers at the time of retirement. The Act applies to every factory, mine, plantation, shop or establishment where 10 or more persons are employed. Gratuity is payable on the basis of 15 days salary for each completed year of service subject to maximum gratuity of Rs. 3,50,000/- on completion of minimum 5 years of service.

The Gratuities Act provides that an employer can make provision in his books of accounts for the gratuity liability accrued during the year and make gratuity payment from the then current revenue as and when an employee retires or can fund the liability by setting up a Trust. The Trustees can manage the fund themselves and

\(^{28}\) EDLI accumulations for un-exempted establishment as on 31.3.2011 - EPFO Annual Report 2010-11
pay the gratuity as and when it arises or goes in for a funding scheme offered by life insurers under a book reserve system

Gratuity paid to an employee is tax free and the employer’s contribution, up to 8.33% of salary, to an income tax approved fund is tax deductible.

Employers with over 500 employees can set up an independent gratuity trust. The trust is to be approved under the Income Tax Act 1961.

4.9 EMPLOYER SPONSORED OCCUPATIONAL PENSION PLANS

Occupational pensions in India can be broadly divided into mandatory provisions (EPF & MP Act) and voluntary provisions29:

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29 Overview of Occupational Pension Plans - Source: Regulation and Supervision of Occupational Pension Funds and Gratuity Funds – S.P. Subbedar, A.N. Thanawala, Renuka Sane, IPRF Working Paper 03/04
Apart from mandatory schemes the employers can also provide for additional retirement benefits to their employees by setting up a Superannuation fund. Though it is not mandatory for employer to provide superannuation benefits, some may like to provide such a benefit as it not only builds a good corpus which is ultimately advantageous to employees after retirement but also provides a number of benefits to the employer as well. Such
important facilities enhance the image of a company for attracting talented personnel and retain quality staff. In tax parlance, the employer is eligible for contributions up to 15% of salary apart from the 12% provident fund contribution under EPF. Many employers take advantage of this provision and set up voluntary superannuation plans. The employers generally go for an approved superannuation fund as this provides tax advantage to the employers.

The Trustees of the Superannuation Fund have two options, either to manage the fund themselves or go in for schemes offered by life insurers for funding the benefit. In both cases, the annuities are required to be purchased from life insurers. The independent trust provides funding of employee retirement benefit independent of the employer.

4.9.1 CONTRIBUTIONS

The employer can contribute either a fixed amount to each employee’s account or a certain proportion of the employee’s salary. The employees can also make contributions to the superannuation fund. In such cases, it would be called Contributory Pension Fund Scheme. The contributions can be made annually, semi-annually, quarterly or on a monthly basis.
4.9.2 BENEFITS

- The employee is allowed to take 1/3rd of the accumulation in his account as commutation on retirement and the balance corpus is used to purchase\textsuperscript{30} annuity. The annuity rates are as offered by the life insurers when the annuity is purchased.

- **Employer Tax Benefits:** The annual contribution by the employer is tax deductible as per Section 36(1) (iv) of the Income Tax Act up to a limit of 27% of employee’s salary. This 27% includes the contribution made towards the mandatory EPF and EPS.

- **Employee Tax Benefits:**
  - Contribution by employer is not treated as a perquisite in the hands of the employees as per Sec. 17(2) (vi) of the Income Tax Act.
  - Interest income on the superannuation plans is tax free
  - Commuted value up to 1/3rd on retirement is tax free as per Income Tax Act.

\textsuperscript{30}Indian Pension Research Foundation, Working paper series, No: 11/04 – Surabhi Sinha\&Renuka Sane - 2004
○ Employee’s Contributions are eligible for tax credit of 20% of the contribution up to a maximum contribution of Rs. 60,000/- under section 88 of the Income tax Act.

○ Annuity payments are taxable.