

Don't rely on providence for pension

Employee Pension Scheme is near broke. Scrap it before it needs bailout

Most employees with a Provident Fund account don't realise that 35% of their contribution is diverted to the horrible Employee Pension Scheme (EPS). This scheme was opposed by employers and unions when it was introduced in 1992 on grounds of sustainability, transparency, governance and returns. However, it was upheld by the Supreme Court based on assurances of the Employee Provident Fund Organisation (EPFO). Interestingly, the government rejected a pension plan proposed for civil servants by the Bhattacharya Committee similar to EPS—with the same birth defect of defining both benefits and contribution—on grounds of sustainability and affordability.

Our worst fears about EPS have now come true: EPFO has unilaterally and substantially reduced benefits under EPS by crimping return of capital, abolishing commutation and increasing pre-retirement penalties. The new rules abolish Para 13, which provided three options for return of capital: a) If the employee opted for 90% of original pension (having given up 10%), then the return of capital was 100 times the original monthly pension; b) if the employee opted for 90% of original pension (i.e. gave up 10%), then the widow got 80% of the original pension for her life and on her death or re-marriage, the nominee got 90 times the original monthly pension as return of capital; and c) if the employee opted to get a fixed monthly pension of 87.5% of the original pension for a period of 20 years, on completion of 20 years, he would get 100 times the original pension. Following this no pension would be paid.

The changes also delete Para 12A around commutation; this removed the option by which an employee could opt for two-thirds of the original pension as reduced pension, and the balance one-third could be commuted and paid as 100 times the one-third as a lump sum. The most damaging change is to Para 12(7), which has changed the 3% penalty per year for early withdrawal before 58 years; for example, if you opted for pension 2 years ahead of the age of 58, the reduction was $3\% \times 2 = 6\%$. This 3% has now been changed to 4%.

Only include these details because they are being gift-wrapped by EPFO as a fine-tuning of the scheme. But nobody should doubt that these represent a broken promise; a unilateral and substantial reduction in future benefits promised for past contributions already made.

The more dangerous problem is that most experts believe that even these modifications are not enough to move EPS to sustainability and it will need either higher contributions or lower benefits. Increasing contributions is difficult; employees do not contribute, employer contributions to the Provident Fund and EPS are defined, and the government has no obligation or willingness till it fills up the hole (as reflected by the prudent decision of the ministry of finance to



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reject an EPFO request for a government bailout).

EPFO has lost touch with its mission and no longer acts in the best interest of its members. It has become self-referential, arrogant and most importantly, dangerous. It does not have clients but hostages (so it can get away with charging 454 basis points to manage a government securities mutual fund). Its dual regulatory and administrative role means that it is both the umpire and the player (so it can suppress competition by denying permission for new exempt PF trust formation). Its goofy service means that participants give up begging for their money (so about 50% of its accounts are dormant with unclaimed money). Its lack of transparency and consistency (definition of wages, treatment of employees above the salary of Rs 6,500, etc) creates opportunities for corruption. It has broken the linkage between interest earned and interest credited (only by a highly questionable reclassification accounting treatment of liabilities and assets).

But instead of being punished or held accountable, EPFO is being rewarded with a bigger kingdom—its mandate has been expanded to cover employers with more than 10 employees (lowered from the earlier 20 employees). There are also rumbles that EPFO proposed to raise its salary coverage limit to Rs 10,000 per month (from the current Rs 6,500). This expansion is built on the false and flawed assumption that benefits are over and above salary. Corporate India has moved to a CTC (cost-to-company) model in which all benefits are included in a number. Any fatwa to raise PF contributions does not increase CTC but reduce take-home salary.

At the well-organised annual Invest India Pension conference in Delhi earlier this month, the agenda, speakers and attendees clearly symbolised the progress in civil service and individual pensions. And the absolute lack of progress in employer pensions. But pension reforms are like ice cream: the more you wait, the more it melts.

We must scrap EPS before the hole becomes unmanageable because tweaking will not overcome a birth defect. We must create competition by allowing employers to pay their Provident Fund contribution to the New Pension Scheme (NPS). And we must legislate that EPFO cannot pay investment returns it has not made. Otherwise we must get ready to write a bigger cheque to EPFO than we did for US64.

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