

## HR Law Hotline

June 03, 2005

### THE FALLOUT OF THE EPF INTEREST RATE HIKE

On May 28, 2005, bowing to political pressure, the Employees' Provident Fund Organisation's ("EPFO") Board of Trustees ("Board"), confirmed the interest rate of 9.5% for fiscal 2004-2005. This rate was earlier proposed by the Ministry of Finance ("MoF"), Government of India. Mindful of the rate of return on the fund, currently at 8.7%. The Board had earlier recommended an interim rate of a more realistic 8.5%. The declared 1% hike translates into a yawning deficit of INR 7160 million (approximately USD 165 million) in the EPFO account.

EPF contributions are invested in government-approved securities and bonds of companies. Previously, the EPF could offer a higher rate of return by investing around 70% of the corpus in Special Deposit Schemes ("SDS"), which gave a 12% return. Today, the SDS rate has sunk to 8%. The EPFO's request to increase the present interest rate on SDS has reportedly been turned down by the government. Postal schemes, which offer high returns, are of no use since institutions cannot invest in these.

The MoF has also declined to bail out the EPFO and hence it would be compelled to dip into its Special Reserve Fund ("SRF") [currently at INR 9,500 million (approximately USD 219 million)] for the 2004-2005 payout to its 400 million members. The SRF has been painstakingly built up over several years out of the forfeited contributions from employers, plus interest.

To enable the funds to increase its earning potential, the government notified a new investment regime from April 2005, allowing non-state provident, superannuation and gratuity funds to invest up to 5% of their assets in equities and up to 10% in corporate debts and equity-oriented funds. The EPFO, however, claims that it has neither the expertise nor the inclination to invest in equities.

The Employees' Provident Fund Scheme, 1952 ("Scheme") is governed by the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 ("Act"). Under S. 17 of the Act, private companies are exempted from the Scheme provided such companies set up private trusts for the administration of their employees' provident fund. Such companies are required to offer, as per the Act, a rate of return which is "not less favorable" than that declared for the EPF. Thus the private company provident funds would also be required to pay the high 9.5% rate of interest. At this rate, the total shortfall for privately-managed funds is estimated at INR 5,000 million (approximately USD 115 million).

What are the solutions for EPF trust managers? They could:

- identify a good investment scheme to seek a return of around 9%. (In fact, many privately-managed funds have been invested in state governments' securities. However, the expected yields have not been forthcoming due to delayed payments.)
- surrender the privately-managed funds to the regional Provident Fund Commissioner, which would compel the government to meet the deficit
- invest in high-yielding junk bonds, with the attendant risk of defaults
- take a loan from the company to meet the deficit, repaying the amount over the years.

The government, well aware of the crisis that it has unleashed, has already proposed that in fiscal 2005-2006, the interest rate of the EPF should be pegged at a more sensible 8%. However, for the current fiscal the funds are plunged into deficit.

Daksha Baxi or Rina Kamath

Source: The Employees' Provident Funds & Miscellaneous Provisions Act, 1952

The Times of India, Mumbai Edition, May 29, 2005  
The Economic Times, Mumbai Edition, May 29 & 30, 2005  
The Hindu Business Line, Mumbai Edition, May 29, 2005 [www.karnal.nic.in](http://www.karnal.nic.in)  
[www.Sify.com](http://www.Sify.com)  
[www.Rediff.com](http://www.Rediff.com)

## Research Papers

### Handbook on New Labour Codes

April 29, 2024

### Compendium of Research Papers

April 11, 2024

### Third-Party Funding for Dispute Resolution in India

April 02, 2024

## Research Articles

### Private Client Insights - Sustainable Success: How Family Constitutions can Shape Corporate Governance, Business Succession and Familial Legacy

January 25, 2024

### Private Equity and M&A in India: What to Expect in 2024?

January 23, 2024

### Emerging Legal Issues with use of Generative AI

October 27, 2023

## Audio

### Third-Party Funding: India & the World

April 27, 2024

### IBC allows automatic release of ED attachments: Bombay HC reaffirms

April 15, 2024

### The Midnight Clause

February 29, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

### Q&A 2024 Protocol to the Mauritius India Tax Treaty

April 22, 2024

### Boost to India's Space Potential: India Liberalizes Foreign Direct

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.

Investment

April 03, 2024

Cyber Incident Response Management

February 28, 2024

