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Providing Social Security through Employees' Provident Fund

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The Employees' Provident Fund (EPF) is the largest superannuation fund in Sri Lanka. It covers nearly 60 per cent of the workforce in the private and semi-government sectors. The total assets of the Fund stood at around Rs. 900 billion as of end December 2010. It accounts for nearly 13.4 per cent of the country's total financial sector assets. Its size is 16 per cent in terms of the Gross Domestic Product of Sri Lanka. EPF is being built up by the mandatory monthly contributions made by both the employer and employee to the EPF Department and the income generated through investing such funds. All members are ensured the receipt of a positive real rate of return on the balance lying in their accounts as at the end of each year. Over the last five decades, EPF has consistently strived to pay maximum retirement benefits to its members or their legal heirs through prudent investment of the Fund while ensuring its safety and the sustainability.

Evolution

The concept of EPF traces back to 1947, when the Report of the Commission on Social Services headed by Sir Ivor Jennings recommended the establishment of a national provident fund, on a contributory basis. Though the necessity of a superannuation fund to provide security at the old age for non-pensionable workers was widely accepted, it took eleven years to materialise this concept. The Employees' Provident Fund Bill presented by Hon. T. B. Ilangaratne, the then Minister of Labour, Housing and Social Services on 12 February 1958 was passed in the

House of Representatives[1] and assented by the Governor General on 09 May 1958. Accordingly, the Employees' Provident Fund was established on 01 December 1958, under the Employees' Provident Fund Act No 15 of 1958. Hon. T B Ilangaratne noted in his speech while presenting the Bill "the scheme has been conceived primarily as a means of providing retirement benefits to the employee at the time when due to advanced age, they are unable to work."

Prior to the establishment of EPF, there existed a few private provident funds or pension schemes established by some employers for their employees, of which the terms were more favourable than those provided by EPF, and in some they were similar. However, all such schemes were confined to limited groups of employees and none of them covered the employed at large, particularly those in the plantation sector. Hon. Peter Keuneman at the second reading of the Bill specifically mentioned that the major improvement in the Bill over the exiting schemes is "that instead of trying to discriminate among different sections of workers on racial grounds or any other grounds, this Bill brings in all categories of workers and employees without discrimination." Accordingly, EPF was created to cover all private and semi-government employees who were not entitled to other forms of retirement benefit schemes such as pensions, approved provident funds and approved contributory pension funds. It also covers those who are employed on casual and temporary basis and the estate workers.

At the inception, the contribution to the Fund was at 4 per cent by the employee and 6 per cent by the employer of the salary of the employee. These rates were increased to 6 per cent and 9 per cent in February 1971 and further to current rates of 8 per cent and 12 per cent, respectively in 1981. Currently, it is mandatory for all semi-government institutions and private sector companies even with one person employed to pay contributions to EPF.[2] Though initially, the law had exempted male and female employees who have passed the age limit of 55 and 50, respectively from payment of contributions, this upper age limit was removed in1985.

Administrative Framework

In terms of the EPF Act, the Monetary Board of the Central Bank of Sri Lanka is entrusted with the responsibility of managing the Fund as its custodian, while the general administration of the Fund is vested with the Commissioner of Labour (CL). As the operational arm of the Monetary Board, the EPF Department was set up at the Central Bank. This department is assigned with several functions, such as the collection of member contributions and surcharges, the maintenance of individual accounts for each and every member of the Fund, investment of funds in a prudent and professional manner while safeguarding the wealth of the Fund, crediting annual interest

1 Hon R.E. Jayathilaka, Hon I.M.R.A. Iriyagolla and Hon Mrs. Kusuma Rajaratna voted against the bill since they believed that the inclusion of estate workers who are non citizens of the country under the EPF Act is unacceptable.

2 The Government employees and members of any private Pension/Provident Fund approved by the Commissioner of Labour are exempted from paying contributions to EPF. However, if a member of an Approved Provident Fund leaves employment and joins an institution liable to pay EPF, the balance in credit of his account shall transfer to EPF.

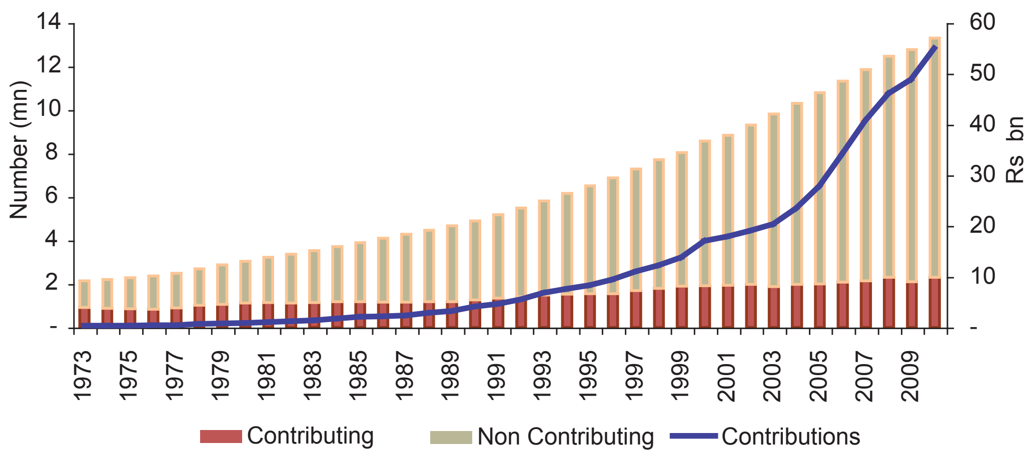
to member accounts calculated on the year end balances of individual accounts, refunding of member balances to eligible members as per the instructions issued by CL, preparation of annual accounts and issue of semi- annual statements of accounts to the members.

As the administrator of the Fund, the Department of Labour (DL) is entrusted with several functions such as the registration of employers and members with the Fund, carrying out of inspections to ensure the compliance with the EPF Act and taking legal actions against non-payment of member contributions, the recovery of surcharges on late contributions from employers, the authorisation of the amalgamation of previous accounts of a member enabling the legitimate member to obtain the benefits and the approval of housing loans enabling members to obtain housing loans from approved lending institutions by pledging their member balances.

Membership

The Fund, which was first inaugurated with specifically named 54 establishments covering public corporations and large private companies now cover more than 62,000 semi-government and private establishments. Number of members of the Fund increased substantially over the last 50 years from about 6,000 members at the end of 1959 to 13.3 million as at end 2010, of which 2.3 million are active members.[3] Though number of inactive accounts is as high as 11.0 million, most of these accounts belong to the active members who have previously worked in other institutions under different identification numbers.

Chart 18.1
Membership and Contribution



3 Active members are the employees whose contributions are currently sent to the EPF Department by their employers. Inactive member accounts do not receive current contributions but hold a balance to the credit of the respective account of members.

Member Contributions

Other than a few institutions that make contributions at higher rates at their discretion, at present majority contribute to the Fund at rates of 8 per cent and 12 per cent, respectively, by employee and employer of the total monthly earnings of the employee. The employers who have failed to send the contributions of a particular month to the EPF Department on or before the last working day of the following month are liable to a surcharge up to the maximum of 50 per cent of the due amount based on the length of the delay. The annual collection, which was Rs. 12 million in 1959, has increased gradually to Rs. 54.8 billion in 2010 with the increase in the number of member accounts and the rise in wages of employees. This also includes the surcharges collected from employers who have failed to fulfill the obligations under the EPF Act.

Fund Management

The overall objective of the Fund in investing its money is to provide a reasonable return to the members, while safeguarding and enhancing the value of the Fund. In terms of Section 5(e) of the EPF Act, the Monetary Board has the power to invest the moneys of the Fund in such securities as the Monetary Board may consider fit and sell such securities as and when it is necessary.

Since the inception of the Fund, almost 98 per cent of its moneys were invested in government securities while the balance was in corporate debt instruments. For the first time in the history, EPF invested Rs. 33.4 million[4] of its funds in the equity market by purchasing shares of Ceylon Grain Elevators and Lanka Lubricants on 24 April 1998. Total investment in the equity market stood at Rs. 384 million by end 1998. Though investments in equity market increased to Rs. 9.8 billion in 2009 and 43.7 billion in 2010, 94 per cent of the EPF investments are still invested in government securities.

The investment climate in the country changed drastically with the end of decades-long war in 2009 and the improvements in the economy. Sri Lanka's stock exchange today is considered to be one of the best performing exchanges in the world reflecting the massive peace dividend that has been generated. At the same time, the government is also committed to reduce its fiscal deficit, over the next few years resulting in a reduced borrowing requirement. The government's target is to reduce the budget deficit to GDP ratio from 8 per cent in 2010 to 6.8 per cent in 2011. Currently, a one percentage point reduction in budget deficit will lower the government borrowing requirement by about Rs.60 billion. Since the budget deficit is expected to decline further in the medium to long-term resulting in reduced borrowing by the government, shifting a part of the EPF funds to other profitable investment avenues such as listed and unlisted equities, debentures and mortgage backed securities, is considered as a prudent investment strategy for managing EPF Funds. In this backdrop, EPF decided to make a strategic move towards other instruments, which provide good yields while securing the safety of the Fund.

4 This amount consisted of investment of Rs. 3.1 mn. in Ceylon Grain Elevators and Rs. 30.3 mn. in Lanka Lubricants.

The banking and financial sector is the largest sector in the Sri Lankan equity market with more than 22 per cent of the total market capitalisation. This sector has always been performing exceptionally well and therefore, since 2005, the EPF had invested in the sector with the intention of creating more wealth for the millions of EPF members in the long-term. Presently, the EPF's exposure to the banking sector is around two per cent of its total portfolio. In addition to the banking sector, EPF has also invested in other sectors including construction and engineering, manufacturing, hotel and travel, telecommunication, and diversified holdings in the Colombo Stock Exchange, and in other instruments such as debentures, mortgage backed securities and selected private equities. With a long term focus, currently EPF has invested more than Rs. 100 million each in fundamentally sound stocks of 51 companies and amounts less than Rs.100 million in 38 more companies.[5] EPF's investments in the share market have enabled millions of its members to indirectly own a stake in some financially stable, fast growing companies and to reap the benefits of the stock market boom. At the same time, EPF will continue to be able to pay interest at a high rate to its members on their balance. Currently, EPF has no exposure to the foreign exchange market or foreign assets.

During 2010, equity investments by EPF have been able to generate an income of Rs. 1.7 billion, which included both capital gains and dividends. In addition, EPF also recorded Rs. 16 billion of unrealised gains from its equity portfolio. Furthermore, EPF earned Rs. 118.2 billion from interest and amortisation gain securing total income of Rs. 121 billion in 2010.

Benefits

Interest Income

Statutorily, all the members of the Fund are eligible to receive an interest at a rate not less than two and a half per cent per annum, approved by the Monetary Board with the concurrence of the Ministers in charge of Labour and Finance. As seen in Chart 18.2, the Fund has provided returns at equal or at a higher rate than the statutorily stipulated rate of nominal interest to its members in the past. It also maintained a positive real rates of return over the last 25 years[6] and also expects to maintain an average real rate of return of over 1.5 per cent to its members in the next 5 year period.

Preserved Benefits

The members are eligible for withdrawing the benefits by (1) reaching retirement age of 55 years for males and 50 years for females, (2) retiring in the case of female members within three months before marriage or within 5 years after marriage, (3) joining pensionable employment, (4)

5 As at 31 March 2011.

6 Over the past 25 year period, EPF has paid an average real interest rate of 1.25 per cent to its members.

Chart 18.2
Growth of the Fund and Rate of Return

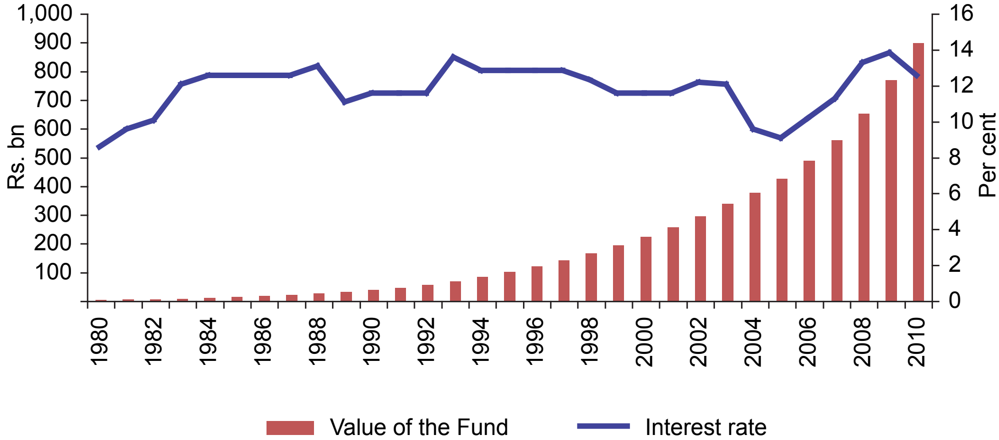
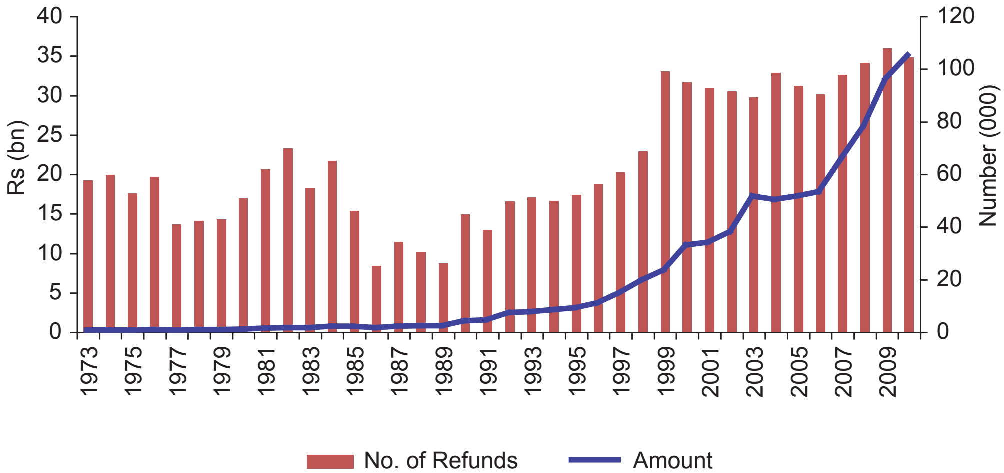


Chart 18.3
Refund Payments



migration, or (5) ceasing employment for the reason of permanent and total incapacity to work. In the case of death of a member, his/her nominees or heirs are eligible to receive the benefits. As shown in Chart 18.3, every year, EPF makes a considerable amount of refunds to its members. Currently, total amount of funds paid out as benefits range around 30-35 billion per annum. However, average amount of a refund paid per member is still around Rs. 200,000. This raises the question whether such a small amount of savings could provide a comfortable retirement life to a person at his old age after 20-30 years of service.

Other Benefits

Under the EPF Amendment Act No 42 of 1988, members of EPF are permitted to pledge the funds to obtain a loan of up to 75 per cent of the balance to the credit of the account in the case of active members and 50 per cent for inactive members for housing purposes.[7] The objective of this scheme is to assist members to own a house, which is also a kind of social security for old age, while securing the retirement benefits. However, 30 - 40 per cent of the loans granted under this scheme are being defaulted every year. The Fund is annually transferring a considerable amount of funds in member accounts to lending institutions to cover the defaulted balances, which include interest at a penal rate plus various other bank charges. Members who default the loan payments suffer due to diminution of the retirement benefits, which otherwise they would have enjoyed. The objective of the Fund is to provide a contended retirement life to its members but this purpose is lost due to heavy defaults. EPF together with the DL has initiated a programme in co-ordination with banks to reduce defaults while enhancing the awareness of the members on the importance of repaying the loans as scheduled.

Other Existing Superannuation Schemes

Government Pension Fund

Over 1.2 million public sector employees are eligible for getting government pension at their retirement age. Persons who are eligible for government pension is entitled to a monthly pension based on the last drawn salary and service period. A minimum of 120 months of gross government service is required to be eligible for a pension. In addition, death gratuity, special compensation to officers who sustain injuries or die while on duty and compensatory pension for dependent are some of the benefits of government pension.

The Employees' Trust Fund

The Employee's Trust Fund established under Act No 46 of 1980 provides superannuation benefits as well as a series of other social and economic benefits such as financial assistance for heart surgeries and kidney transplant, education scholarships for children of members, low

7 Currently 5 lending institutions namely, State Mortgage and Investment Bank (SMIB), Housing Development Financial Corporation (HDFC) Bank, Bank of Ceylon, People's Bank and Co-operative Rural Banks provide loans under this facility.

interest housing loan schemes etc. to its members. All public sector employees who are not entitled to the Govt. Pension Scheme and all private sector employees are members of this Fund while their employers are required to send 3 per cent of the gross earnings of their employees to the Fund on monthly basis. This is a non-contributory benefit to the member as only the employer makes a contribution on behalf of the member to the Fund. In addition, self employed persons have also been made eligible to obtain membership of this Fund in terms of section 18 of the Employees' Trust Fund Act. No 46 of 1980. Self employed abroad were also made eligible under the Employees' Trust Fund (Amendment) Act No.47 of 1988. Total wealth of the Fund was about Rs 103 billion by end of December 2010. The Fund serves for about 2.1 million members.

Private Provident/Pension Funds

At the time when the EPF was established there were several private pension/ provident funds managed by private institutions. Currently 171 such funds approved by the Department of Labour serving 157,494 members are operating in Sri Lanka. Members of these funds are eligible for more or equal benefits enjoyed by the members of EPF. The EPF (Amended) Act No 6 of 1975 prohibits creation of such new funds and makes it compulsory for all private sector employers and employees to contribute to EPF. However, an amendment to the EPF Act in 2009 allows such existing approved provident funds to create pension funds if desired.

Proposed Benefit Schemes

Early Withdrawals for Housing and Medical Purposes

The cabinet has recently granted approval enabling the refund of up to 30 per cent of the balance of individual accounts for housing and medical purposes. Even though, such a facility may improve the welfare of the members, and eliminate some weaknesses in the existing housing loan scheme, this proposal too dilutes the original objective of the Fund. Therefore, implementation procedures and guidelines of this scheme have to be laid down carefully to preserve the objective of the Fund.

Pension Fund

Most of the EPF beneficiaries who withdraw money from the Fund use them for one time investment such as construction or development of a house or meeting social obligations such as dowries, weddings or education of children. Some lose their funds by investing in inappropriate ventures. Only a few beneficiaries who receive large sums of money as benefits invest their funds wisely and secure their retirement life. Therefore, in view of providing monthly remuneration at the retirement age, a proposal to establish a contributory pension fund for the semi-government and private sector employees is now in the process of being approved by the Parliament. It has been proposed to establish two pension funds to cover Sri Lankans working abroad and self-employed persons who are not eligible for any form of superannuation benefits under existing pension or provident fund schemes.

Enhanced Social Security through Repositioning EPF for the New Era

EPF is committed to be the most caring superannuation fund in the region, enabling its members to have a contented retirement life. In line with the strategic objectives of the Central Bank of Sri Lanka, which celebrates its 60th anniversary in 2010, EPF is in the process of re-engineering its functions to provide a more efficient service to its members.

EPF Department which was a victim of the terrorist attack on the Central Bank in January 1996 suffered due to the interruption to the computerised database and destruction of bulk of its documents. Details of the payments made were gathered from preserved archives of the then banking department to ensure the refund payments. The archives of the EPF Department containing the original files relating to information about member contributions and the master files carrying member details were saved and transferred to the new office and resumed operations immediately on manual basis. Gradually the EPF administration took initiatives to computerise its rebuilt database and major operational functions under a modernisation programme commenced in 1996. Initially, internal operations of the Fund were computerised with software developed in-house by the Central Bank's staff. An AS-400 type platform of high capacity was introduced to operate all functions through a computer based system in 1998. Furthermore, the accounting, material management and fund management functions were automated from manual to a computer based system through software called "SAP" in 2006. Though, these systems have enabled the improvement of accuracy and efficiency of the work processes, the re-engineering process has been initiated with assistance of the IT Department of the Central Bank to meet the needs of an emerging economy and to cater to a larger number of members with greater efficiency. The re-engineering process will convert the current system to a double entry based ledger system which will lay the foundation for EPF to move to a fully IT based Banking Model by 2012. The new AS-400 System has commenced its live operations with effect from 01 January 2011.

Parallel to the computer system for re-engineering, EPF launched a new project called "Re-registration" in collaboration with DL to register all existing EPF members based on the details in their National Identity Card (NIC). Under this system, existing employer centric identification system will be transformed into a member centric identification system. The first phase of the project was concluded on 30 October 2010. Under this project NIC information of nearly 800,000 members were collected and the Fund is now in the process of registering them under the New Member Registry maintained in the EPF database.

Learning through experience, the Phase 2 was redefined to eliminate the weaknesses and the high cost involved in the data collection process. Under the new phase of the project, a new member registration form namely "Form RR6" has been introduced to register all new recruits on real time basis with effect from 1 November 2010. All registered employers and all new employers who will commence business in future are required to furnish NIC details of new employees recruited after 1 November 2010 through "Form RR6" along with the member details (Form C/C3) when their first EPF contribution is sent to the EPF Department of the Central Bank, in addition to the "Forms A, B and H", which should be submitted to the labour office within 14 days of recruitment. Further, employers having employees who have not yet submitted their NIC details under Re-registration Project are also requested to submit their NIC information through "Form RR6". Duly completed "Form RR6" should accompany a photocopy of the NIC of the employee, certified by the employer with his signature and the company stamp. With the successful completion of this project, EPF is expected to register almost all active members of the Fund under the New Member Register and assign their NIC number as their unique identification number. This system will enable EPF to manage its database more systematically and also to amalgamate the numerous accounts of an individual member under the unique identification number. The re-engineering programme once completed would reduce the time involved in the refund process considerably, enabling EPF to provide a more efficient service to its members.

Currently, the establishments that have 150 or less are required to send details of members such as name, EPF member number and NIC number, if available, by filling a form called "Form C" together with contributions (the amount to be credited to the particular member) while the establishments with more than 150 employees should send such information by completing a form named "Form C3" every 6 months i.e., June and December of the year. This procedure involves a heavy cost to the Fund and delays of crediting the member balances to the individual accounts as EPF has to wait till member details are received, enter this information to its computer system and check the accuracy. Therefore, the existing system of collecting information in printed form is expected to be replaced with an electronic data collection system soon. The electronic data collection and funds transfer mechanisms called 'e-collection" and "direct debit" systems, which expect to collect all details of members through electronic means such as e-mail, CD, Web, etc., and transfer their member contribution electronically are now in progress. Once these projects are completed, EPF would be able to credit at least 80 per cent of its member accounts within 1-3 days of receiving money and relevant member information. These systems will also reduce the cost involved in processing data substantially while assuring the accuracy of the data. Currently, more than 1,000 employers covering more than 13 per cent of the total membership use electronic means of data transmission (either e-mail, or CD) to send the member information. An awareness programme is now underway to educate the remaining employers on the new system and to bring them into the process.

EPF is also required to preserve the member details until they reach the retirement age to ensure that each legitimate beneficiary receives entitled benefits accurately. The Image Scanning Project, which expects to scan all the archival documents while scanning the current documents on real time basis will commence in June 2011. Under this project all scanned documents will be stored electronically enabling retrieval of data for easy reference. This project will reduce the cost of storing, handling and securing printed information and the time consumed for retrieving the files.

Success of the EPF re-engineering process depends mainly on the awareness of both employers and the members on the work that EPF is doing for their benefit. Therefore, it is important to ensure that all four parties, i.e., staff of EPF, labour officers, members and employers join hands collectively to achieve the objectives of these projects. An aggressive awareness campaign is now in progress to involve all four parties together to work as a team. Furthermore, EPF is to launch a campaign to expedite the issuance of NIC to EPF members with assistance of the Registrar of Persons. In addition to awareness programmes mobile services are organised to cover all three sectors, i.e., urban, rural, estate and print and electronic media are widely used to get the message across the people. The entire effort of re-positioning EPF to best suit the needs of the new era will reduce the cost of managing the Fund while ensuring higher benefits to the members.

Summary

EPF was created as a social security scheme for securing superannuation benefits at the old age of the employees who are not eligible to receive any other form of superannuation benefits. In keeping with its statutory obligations, EPF, as the largest superannuation fund in Sri Lanka, has provided retirement benefits worth more than Rs. 258 billion to 2.6 million members during the last four decades. Honouring the trust that the government had placed in the Central Bank, the Fund has been managed prudently while enhancing and safeguarding the wealth of the Fund.

With the changes in the investment climate of the country and the government's commitment to reduce its budget deficit, the Fund is facing a new challenge to look for alternative investment opportunities. The Fund should be ready with its manpower and skills to face this challenge probably to look for investment opportunities in the international markets. Addressing the issue of inadequacy of the retirement entitlement of the beneficiaries to have a safe and contended retired life and to provide a suitable scheme for self employed people and Sri Lankans employed aboard who are not covered by EPF or any other superannuation scheme are other major challenges faced by the Fund. However, EPF has planned to face these challenges in the new era with its dedicated and committed staff.

EPF has given attractive returns to its 13.3 million members in the past. In 2009, EPF gave benefits at 13.75 per cent on member balances, which is by far the highest ever rate of return declared by the Fund. It would also ensure giving out a better positive real rate of return to all its members in the future. Several strategic measures have been put in place to minimise the cost and improve efficiency of EPF operations. EPF being the largest single fund, which guarantees maximum possible social security to its members at their retirement, will continue to discharge its responsibilities and duties within its legal framework in a professional and prudent manner, providing an efficient and caring service to its members.

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