



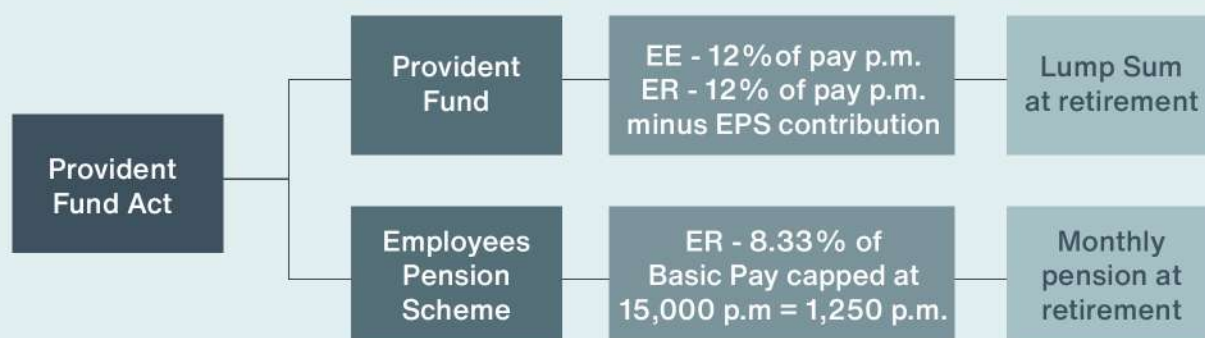
Provident Fund and Employees' Pension Scheme Developments

Aon Point of View

Introduction: The recent circular by the Employees Provident Fund Organization (EPFO) dated 20th February 2023 has once again opened the doors to a large section of the organized workforce who are part of the statutory Provident Fund (PF) scheme to opt in for the Employees' Pension Scheme (EPS) on an uncapped basis. In a developing country like India, the employee takes responsibility of his own Retirement savings with support of mandatory employer sponsored plans like Provident Fund. However recent developments surrounding the Provident Fund and its sub-plan Employees' Pension Scheme would result in the statutory PF authority (EPFO) taking up responsibility for providing pension to the organized workforce at significantly higher rates as compared to what they are paying currently. Let us look at the recent developments in detail.

Background: The Employees' Pension scheme or the EPS-95 is a sub-plan of the statutory Provident Fund (PF) plan where both the Employer and Employee contribute 12% of applicable pay every month towards the PF plan. Out of the 12% contributed by the employer, 8.33% of pay is redirected to the EPS plan. As per Aon surveys, majority organisations (76%) contribute towards the PF on full Basic salary and do not restrict the contributions to the statutory wage cap of INR 15,000 per month. However, it is important to note that the 8.33% of pay redirected to the EPS scheme from the employer's contribution is on pay statutorily capped at 15,000 p.m., therefore the maximum amount redirected to the EPS plan every month is INR 1,250 only and majority gets allocated towards the PF scheme.

How the Employer Contributions under Provident Fund Act are split between PF and EPS as per existing rules

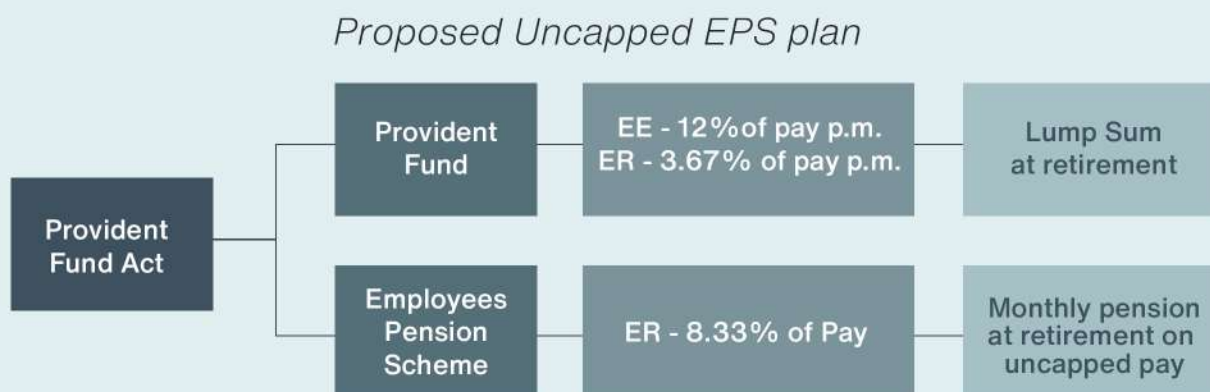


While the PF plan pays out the accumulated fund with interest credits at retirement as a lump sum, the EPS-95 plan provides a monthly pension to the retired members of approximately 50% of last drawn 60 months' average salary again on capped pay of INR 15,000 which is fully paid by the EPFO. As the pay is capped at INR 15,000, the pension one can get on retirement is approximately 7,500 per month. The EPS-95 plan was also closed completely to new hires with pensionable salary above INR 15,000 p.m. who joined post 1st September 2014. This is also the same date when the EPFO discontinued the option of contributing towards the EPS-95 plan on an uncapped pay.

Key Features of the current Employees' Pension Scheme:

FEATURE	DESCRIPTION
Employer contribution	8.33% on wage capped at wage of INR 15,000 p.m
Government contribution towards EPS plan	1.16% of wages
Employee Contribution	None
Pension Benefit Formula	Pension per month = $\frac{1}{70} \times \text{pensionable service} \times \text{Applicable Pay p.m.}$ capped at wage of INR 15,000 p.m. (results in a pension of approximately 7,500 per month if one completes 35 years in service)
Pensionable Service	Years for which contributions are made to the EPS95 plan. An additional 2 years of service is credited on completion of 58 years of age and 20 years of service
Pension to spouse on death	50% of member pension
Min age/service for receiving early pension	50 years age/10 years' service
Early Pension reduction factor	4% p.a.
Pension Payments and Liability	Pensions are paid to the retired employee till death and 50% of pension is paid to spouse thereafter by EPFO

Recent Developments: Over the last few months, the EPS-95 plan has generated a lot of interest as the Supreme Court in judgement dated 4th November 2022, directed the EPFO to allow all eligible employees to opt for the EPS-95 plan on uncapped basis once again with the window open for 4 months since the date of judgement. What this means is employees can redirect 8.33% of their pay on an uncapped basis to the EPS scheme retrospectively and in future and the balance 3.67% of the employer's contribution goes into the PF scheme. This will allow employees to get a pension which would be 50% of average salary of the last 5 years before retirement on an uncapped basis leading to a significant increase in the pension amount at retirement. Not surprisingly, the amount available from the PF scheme as a lump sum at retirement goes down materially as a major part of past accumulated PF corpus gets reallocated to EPS.



The judgement and subsequent circulars by the EPFO indicate that the choice to move to uncapped EPS-95 would be done retrospectively from the date of joining the EPS plan. Therefore, once the employee opts for the higher pension option, the applicable accumulated amount under the PF together with accrued interest will get transferred to the EPS plan. At this time, the retrospective applicability is an assumption. The exact amount that would be transferred from PF to EPS plan and confirmation on any change in the pension plan benefits would be available to the applicant member in due course. The EPFO in its recent update has extended the date to apply for the uncapped EPS plan upto 3rd May 2023.

Illustration: The below table summarizes the change in allocation of ongoing contributions between PF and EPS under the uncapped plan for an employee earning a pay of INR 100,000 per month. Under the uncapped plan, out of the employer contribution of 12% of pay (INR 12,000), 8.33% of the pay (INR 8330) would be allocated to the EPS plan and balance 3.67% (INR 3670) would be allocated to the PF plan. Under the existing plan, the EPS contribution is limited to 8.33% of the capped pay 15,000 leading to a contribution of INR 1250.

Scheme	Existing Capped EPS Plan	Uncapped EPS Plan	Impact
Employer PF Contribution (A)	10,750	3,670	PF contribution goes down
Employer EPS Contribution (B)	1,250	8,330	EPS contribution goes up
Total Employer Contribution (A+B)	12,000	12,000	Overall contribution remains same
Employee Contribution	12,000	12,000	No change

Eligibility for uncapped EPS plan:

Based on the circular issued by the EPFO, the following category of employees would now be eligible for opting for the uncapped EPS plan

- Existing serving employees who had joined prior to 1 September 2014 and contributing towards PF scheme on uncapped pay at that date
- Retired Employees contributing towards PF scheme on uncapped pay, who were in service prior to 1 September 2014 and retired after 1 September 2014 but could not exercise the choice would also be given another opportunity to move to the uncapped EPS plan

Employees who started their careers after 1 September 2014 with more than 15000 p.m. pay remain outside the scope of the uncapped EPS plan. Additionally, employees who retired before 1 September, 2014 without exercising the choice earlier would also not be allowed to participate in the uncapped EPS plan

Is uncapped EPS plan more beneficial financially?

High level calculations suggest that it would be beneficial for employees to shift to uncapped EPS 95 plan if their intent is to get regular income or pension from the Provident Fund accumulations. To understand the opportunity cost, we take an example of an employee joining work with a starting pay of INR 15,000 per month with an annual salary increment of 7% over a service period of 35 years. The 8.33% of pay, most of which is currently being directed to PF plan would end up accumulating approximate fund of INR 64 lakhs at retirement assuming interest credits at 8% p.a. by the EPFO. If the employee uses this fund to buy a pension from the market on retail basis, he / she would end up getting a monthly (joint-life) pension of approximately INR 38,000. However, if the same employee chooses to opt for the uncapped EPS plan and transfers this accumulated fund from PF corpus to the EPS plan, he/she might end up getting approx. INR 65,000 per month pension from the EPFO which is almost 70% higher against the same set of contributions

Accumulated value of contributions at retirement on 8.33% of pay	INR 64 lakhs	Assumptions: <ul style="list-style-type: none"> Starting pay: INR 15,000 p.m. EPS contributions: 8.33% of uncapped pay Salary growth: 7% p.a. Tenure: 35 years Interest earnings on PF: 8% p.a.
EPS Pension from above fund	INR 65,000 p.m.	
Pension expected from insurers from above fund	INR 38,000 p.m.	

The above calculations will hold good provided the existing EPS benefit remains unchanged. However, one has to consider a possibility of the government reducing the pension benefits in future if the scheme becomes unsustainable.

Should you opt for the uncapped Employees' Pension Scheme at the expense of Provident Fund?

At face value, it makes financial sense to opt for the uncapped EPS plan, however there could be several other considerations that one should keep in mind before moving to the EPS plan. These include some personal factors which might encourage the employee to continue with the PF plan to obtain a higher lump sum at retirement, for example, plans to invest in property at retirement, ability to generate superior returns by selfmanaging the PF fund, poor health and life expectancy where pensions may not help, early retirement plans where higher lump sums would be preferred and legislative risk of pension benefits being reduced by the Government in future. It is also to be noted that Provident Fund lump sums are tax-free whereas pensions are taxable, again making PF more attractive.

However, for those retired or nearing retirement and those who do not need a high lump sum at retirement, this option under EPS-95 plan may present a profitable arbitrage opportunity where higher pensions can be obtained with the same Fund. In a market scenario where interest rates are expected to reduce over a longer period of time and longevity is expected to improve, buying pensions from retail market could be an expensive proposition and the defined benefit nature of the EPS 95 plan would also protect the employees from such adverse market conditions.

At this stage, there does not seem to be any indication that employers may have to financially support the EPS 95 plan, but one needs to watch out for future changes in PF legislation. These changes may lead to higher contribution requirements from employer or employee to sustain the EPS-95 plan. The EPFO has acknowledged in the past that there could be sustainability issues with an uncapped EPS plan. Therefore a possible change in design of the EPS plan in future leading to lower pensions cannot be ruled out.

Should you opt for the uncapped Employees' Pension Scheme at the expense of Provident Fund?

Employees should do their own due diligence well in advance on their choice between PF or higher EPS-95 plan as this may be the last opportunity to move to the uncapped EPS plan. The last date of the application is 3rd May 2023. For application the employee needs to visit the URL <https://unifiedportal-mem.epfindia.gov.in/> and submit an application for the uncapped EPS plan. The application required includes providing basic data such as Name, UAN, Aadhar, Date of Birth and Aadhar linked phone number. Thereafter a joint option form needs to be submitted online and one could also add all prior employment data as part of the application. An express declaration is also being sought as part of the application on employee's approval to transfer applicable accumulated PF to the EPS plan to be eligible for the uncapped EPS plan.

Employers who have historically contributed to the PF plan on an uncapped basis should support their existing and past employees with historic data and also help with the joint approval to apply for uncapped EPS plan, as and when requested by employees. Organisations could also look at hosting education sessions on this topic for their employees as part of their financial wellness agenda and overall benefits philosophy.

Some finer details around the amount to be transferred from PF to EPS, final pension formula and other operational guidelines around implementation are expected in subsequent circulars by the EPFO.



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