Regulatory changes concerning new investment pattern for Non-EPFO PF, Gratuity, Superannuation

Technical update

The Ministry of Finance has published fresh proposed changes to the existing pattern of investment for self-managed Non – EPFO regulated Provident Funds, Self-Managed Gratuity Funds and Superannuation funds. This is not applicable to Exempt (EPFO regulated) Trusts. The notification is yet to be Gazetted, though it is due to be effective 1 April 2015.

Summary of the key changes

	Investment Pattern	Existing Pattern	Proposed New Pattern
		Percentage amounts to be invested as on 1st April 2009	**Percentage amounts to be invested as on 1st April 2015**
(I)	**Government Securities & Related Investments** The types of assets permissible within this category have not changed	Up to 55%	Minimum 45% and maximum of 50%
(II)	**Debt Instruments and related Investments** In addition to the existing sub category of assets permissible in this section *Summary of existing sub-categories:* (A) Debt Securities with maturity of less than three years tenure issued by Bodies Corporate including banks and financial institutions; (B) Term Deposit Receipts of not less than one year duration issued by scheduled commercial banks, subject to certain conditions (C) Rupee Bonds having an outstanding maturity of at least 3 years issued by the institutions of the International Bank of Reconstruction and Development, International Finance Corporation and Asian Development Bank. *New sub-categories added:* *i.* Basel III Tier-1 bonds issued by a schedule commercial bank regulated by RBI *(maximum allowed at any time to be 2% of total portfolio)* *ii.* Units of Debt mutual funds as regulated by SEBI *(maximum of 5% of net new additions in any one year allowed and also the fund at any time not to exceed 5% of total portfolio)* iii. Infrastructure related debt instruments such as listed corporate debt from a company in the sector; government debt issued for the purpose of development of	Up to 40%	Minimum 35% and Maximum of 45%

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	infrastructure; infrastructure bonds; infrastructure debt mutual funds		
(III)	**Short Term Debt Instruments and Related Investments** In addition to the existing money market instruments and units of money market mutual funds *New sub-categories added:* i. Term deposits of up to one year issued by a scheduled commercial bank satisfying the stipulated criteria	Up to 5%	Up to 5%
(IV)	**Equities and related investments** Further details for the existing criteria is given in the new pattern *Existing pattern* Shares of companies on which derivatives are available on BSE or NSE or equity linked schemes of mutual funds regulated by the SEBI; *Further details given in the new pattern* - Market capitalisation of the company being invested in must not be less than INR 5000 crores on date of investment - The mutual funds must have a minimum of 65% of the fund invested in companies listed on the BSE or NSE. *(maximum of 5% of net new additions in any one year allowed and also the fund at any time not to exceed 5% of total portfolio)* - Details of the types of Exchange Traded Funds that can be invested in are provided	Up to 15%	Minimum 5% and up to 15%.
(V)	**Asset Backed, Trust Structured and Miscellaneous Investments** *New Category introduced which includes* *(A)* Commercial or Residential Mortgage based securities *(B)* Units in Real Estate Investment Trusts *(C)* Asset Backed Securities *(D)* Units in Infrastructure Investment Trusts The above are to be listed, or proposed to be listed and where they are regulated by SEBI There are minimum credit rating criteria specified as well.	N.A	Up to 5%

The investment patterns, as before, have to be adhered to by the end of the financial year and are applicable to fresh accretions to the fund, after allowing suitably for outgoes of the fund.

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The key changes

- The Government and Debt Instruments categories now have stipulated minimum percentages, 45% and 35% respectively. The maximum percentages in these have been updated slightly, increasingly the allowable percentage in non-government debt instruments.
- The revised pattern will make investment in equity a mandatory requirement. A minimum investment of 5% and up to a maximum of 15% is the major change in the notification.
- The above means that 85% of fresh investments are stipulated.
- A number of new types of instruments have been introduced, most notably in the area of infrastructure. A clear result of the direction the government is taking in the hope to raise long term funds through this route.
- The overall effect of these changes would be to reduce the flexibility within the various categories. However, the overall flexibility has increased with the introduction of another category.

Further details

- The proposed notification has many new paragraphs with references to the Trustees discharging their fiduciary duty in a more active, accountable and planned manner

  For instance, specific sentences are included about:

  - taking suitable steps to control and optimise the costs associated with managing the investments
  - ensuring the trust has a process that is accountable and transparent
  - decisions about assets should be taken after suitable due diligence on the risks of that asset/security
  - trustees should adopt and implement a set of guidelines to monitor concentration of risk
  - For the first time there is a paragraph clarifying trust investments should be “at arm’s length”. Details are given that a maximum of 5% of net new additions in any one year and also the fund at any time not to exceed 5% of total portfolio cannot invested in any company/organisation that the sponsor of the trust owns more than 10% of that companies’ securities.

Thoughts for Trustees - Next steps

Trusts that are managing their investments will need to review these guidelines in detail and assess their current processes. Trustees will need to monitor compliance and performance in a more tangible manner.

The changes proposed, especially with the introduction of a minimum in equities would mean that there is much greater emphasis on control and monitoring of the investments portfolio. The MIS and reporting function of the retirement benefits would have to be tightened.

- Do you have a statement of investment guidelines/principles?
- How will you ensure the new pattern is complied with?
- Will you review the new opportunities presented?
- If you currently have your funds managed with an insurance company; is it time to review that strategy?
- What external investment advice should be sought?

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We suggest that Trustees review their investment governance process, decide how the new pattern impacts your particular trust and ensure that this is on the Trustee meeting agenda for the new financial year.

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For more information, please contact your Towers Watson Consultant or email us at benefitsindia@towerswatson.com

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