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INDIA PROPOSES INCREASE IN PROVIDENT FUND RATE

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A proposed increase in the Provident Fund (PF)'s interest rate to 8.65% from 8.55%, payable on members' accumulations for 2018–19 could impact employers' year-end long-term benefits, liabilities and costs. The increase was recommended by the Central Board of Trustees of the Employees' Provident Fund Organization (EPFO), which administers the compulsory contributory pension and insurance scheme. Before taking effect, the proposal must be approved by the Ministry of Finance and sent on to the Ministry of Labour.

IMPACT ON TRUSTS, SPONSORING EMPLOYERS

Exempt provident funds are defined benefit schemes for accounting purposes, so employers will need to assess the impact of the liability increase, including changes to the trust's long-term assumptions. The increased PF rate could reduce trusts' reserves if their income falls short of 8.65%, requiring sponsoring employers to provide additional funding. However, trusts could choose to adjust the portfolio (fixed income and equity) to bridge the shortfall.

The actuarial impact will depend upon the interplay of multiple factors, such as:

- ***Changes in investment portfolio returns.*** The yields achieved by most trusts could have exceeded the previous year's yields by about 0.35% due to increased bond yields — this could reduce the impact of the PF rate rise.
- ***Duration of any mismatch between trust assets and liabilities.*** PF trust liabilities typically last for longer periods of time relative to assets. However, increases in the discount rate will result in a larger reduction compared to assets in market value terms — this would limit the impact of the increase in the PF rate.
- ***Reserve size.*** Trusts with larger proportions of reserves relative to the interest-bearing liability would be better able to absorb PF rate rises.
- ***Asset valuations.*** Changes to asset valuations could result in reduced asset values.

RELATED RESOURCES

- Press Release (Indian government, 21 Feb 2019)

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