# 7th Capcity Building Seminar in Retirement Benefits Online Edition 2021

## 5 February 2021

Topic 1 - 11.00 am – 1.15 pm, India time

Topic 2 - 3.00 pm – 5.15 pm, India time

Institute of Actuaries of India

# Speakers and Facilitators

**Topic 1**
**11:00am – 1:15pm**

**Kulin Patel**

**Khushwant Pahwa**

**Arpan Thanawala**

**Topic 2**
**3:00pm – 5:15pm**

**Chitra Jayasimha**

**Kartikey Kandoi**

**Hemanshu Jain**

# Today is not your normal webinar…

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Main Session/"Meeting"

Transitions Automatic

Breakout Rooms | Breakout Rooms | Breakout Rooms | Breakout Rooms

Transitions Automatic

Main Session/"Meeting"

1 x McQ for **CPD**

1 — Recording

2 — No recording

3 — Specific Unmute only — Recording

- Use same Zoom link for Topic 2 and re-login
- Flow of Topic 2 similar
- Attendance at BOTH topics needed for CPD

**IAI support**

**Feedback Email to follow**

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# “Breakout Rooms”

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9

## Groups assigned

- Mix of Fellows/Associates/Students/Others
- Where possible tried to include someone in the practice area

## Speakers / Faculty

- To help clarify expectations
- Make sure sufficient progress made
- Will rotate between their allocated Rooms

## Tips

- DO NOT “Leave Room” or “Leave Meeting” in Rooms
- Rooms will be opened/closed automatically
- A 5 minute warning message will pop up on screens for information

# “Breakout Rooms”

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| Topic 1 | Arpan - Category 1 Qs | | | Khushwant - Category 2 Qs | | | Kulin - Category 3 Qs | | |
|---|---|---|---|---|---|---|---|---|---|
| Topic 2 | Kartikey - Gratuity | | | Chitra - Leave | | | Hemanshu - PRMS | | |
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| | Shivam Agrawal | Twinkle Agarwal | Shruti Vinod Shetty | Y. P Sabharwal | Srinivasan Nagasubramanian | Vinayeta Sunil Gaba | Suranjan Banerjee | Unique Arora | Surbhi Jindal |
| | Sunita Bhatt | | | | Tanu Saharan | | Vichitra Malhotra | | |

# 7th Capcity Building Seminar in Retirement Benefits
# Online Edition 2021
# 5 February 2021

## Topic 1 – Code on Social Security, 2020

**Implications on Actuarial Valuations**

**Khushwant Pahwa & Arpan Thanawala**

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# Code on Social Security - Introduction

- Labour falls under the **Concurrent List** of the Constitution. Therefore, both Parliament and state legislatures can make laws regulating labour.

- Central Government stated that there are **over 100 state and 40 central laws regulating various aspects of labour** such as resolution of industrial disputes, working conditions, social security and wages. The Second National Commission on Labour (2002) found existing laws to be **complex, with archaic provisions and inconsistent definitions**.

- To improve ease of compliance and ensure uniformity in labour laws, the Central Government recommended the **consolidation of central labour laws into broader groups** such as:

  (i) industrial relations,
  (ii) wages,
  (iii) social security,
  (iv) safety, and
  (v) welfare and working conditions.

- In 2019, the Ministry of Labour and Employment **introduced 4 Bills to consolidate 29 central laws**. These Codes regulate: (i) Wages, (ii) Industrial Relations, (iii) Social Security, and (iv) Occupational Safety, Health and Working Conditions.

- While the **Code on Wages, 2019 was passed by Parliament**, Bills on the other three areas were referred to the Standing Committee on Labour. The Standing Committee has submitted its report on all three Bills. The government replaced these Bills with new ones on September 19, 2020.

# Code on Social Security – Journey so far..

- The Code On Social Security, 2020 was **introduced in the Lok Sabha on 19th September 2020**.

- The following table summarises the journey of the Bill:

**Introduced to Lok Sabha**
- Sep 19, 2020

→

**Passed by Lok Sabha**
- Sep 22, 2020

→

**Passed by Rajya Sabha**
- Sep 23, 2020

→

**Notified in the Official Gazette**
- **Pending ****

- On the date of making this presentation, the notification of the Code in the Official Gazette of India was pending.

- The code shall **come in-force from the date it is notified in the Official Gazette of India**. Once notified, the Code on Social Security, 2020 **will replace 9 existing laws** (detailed in the next slide).

- The government intends to implement / notify the Code of Social Security, 2020 and other labour codes from 1st April 2021.

# Acts merging into Code on Social Security

- **The Payment of Gratuity Act, 1972**
- **The Employees' Provident Funds and Miscellaneous Provisions Act, 1952**
- **The Employees' State Insurance Act, 1948**
- **The Employees' Compensation Act, 1923**
- The Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959
- The Maternity Benefit Act, 1961
- The Cine Workers Welfare Fund Act, 1981
- The Building and Other Construction Workers' Welfare Cess Act, 1996
- The Unorganised Workers Social Security Act, 2008

*The Code on Social Security, 2020*

# Key changes impacting actuarial valuations

The **key changes** impacting actuarial valuations of employee benefits are as follows:

- Change in the **DEFINITION OF WAGES**
- Change in **VESTING CRITERIA** for **FIXED TERM EMPLOYMENT**
- Change in the **VESTING CRITERIA FOR JOURNALISTS**

The changes and the impact of the same on actuarial valuation of employee benefits (gratuity, leave encashment, etc.) are discussed in the following slides.

# Definition of Wages: What does Section 2 (88) require?

Section 2, sub section 88, Definition of Wages requires that the **Wages be at least 50% of Total Compensation**:

| Old World | New World post implementation |
| --- | --- |
| Qualifying wage for gratuity defined as:<br><br>**- Basic Pay**<br><br>**- Dearness Allowance** (Allowance paid to employees to offset the impact of inflation)<br><br>And there was **no minimum limit** on what proportion of total compensation should the qualifying wage should constitute. | Qualifying wages means **all remuneration**, whether by way of **salaries, allowances or otherwise**, and **includes**,—<br><br>- basic pay;<br>- dearness allowance; and<br>- retaining allowance, if any,<br><br>But **does not include**:<br><br>- Bonus payable under any law<br>- Value of any house-accommodation<br>- Contribution to any pension or PF plus interest accrued<br>- Conveyance allowance<br>- Sum paid to defray special expenses<br>- House rent allowance<br>- Any award / settlement under order of a court / Tribunal<br>- Overtime allowance<br>- Commission payable to the employee<br>- any gratuity payable on the termination of employment;<br>- any retrenchment compensation or other retirement benefit payable |

**Inclusive Definition!**

**Minimum Limit:** Components in red cannot be more than 50% of overall!

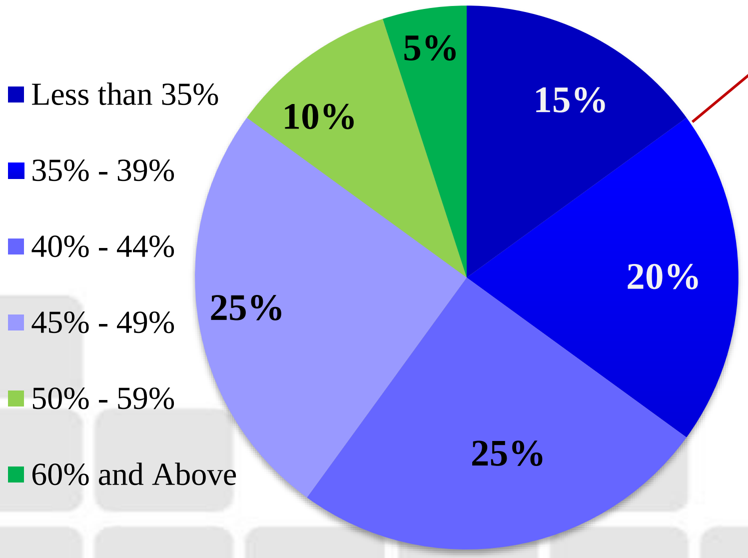
# Definition of Wages: Implications of change (1)

- From actuarial valuations perspective, the new definition of wages is the key change, which may impact the costs of many organisations and take-home salaries for employees.

- The exclusion limit of 50% is aimed at ensuring that companies do not adopt compensation structures which result in wages being reduced below 50% of the total remuneration.

- To ascertain **impact of change** (both **in terms of proportion of companies impacted** and the **extent of impact**), we **analyzed (Wage) Basic salary to Gross Salary ratio** of some of the top listed Companies for whom we have performed the year end valuation for FY 2019 - 20.

Pie chart below captures the **split of Companies based on their Basic Salary (and DA) to Gross Compensation ratio**:




It appears that qualifying wages for most organizations will see a major increase, likely to result in an increase in liability.

25% to 30% increase in liability, in addition to the normal increase, is something that can be easily expected.

# Definition of Wages: Implications of change (2)

As mentioned previously, new definition of Wages will have **direct impact on actuarial liabilities**.

**GRATUITY ACTUARIAL LIABILITY** (Post Employment Benefit)

- The **"applicable wages" considered in gratuity calculation is expected to increase** for most companies. It shall result in a **one-off increase in gratuity liability.**
- The one-off increase in liability shall be **charged to Income Statement or Other Comprehensive Income (OCI)** depending upon various factors and the applicable accounting standard.
- The extent of this one-off increase in liability will depend on the level of qualifying wage in the existing the compensation structure.

**EARNED LEAVE / LEAVE ENCASHMENT LIABILITY** (Other Long Term Employee Benefit)

- Similarly, the companies that provide leave encashment on Basic salary (and not gross salary) will experience a one-off increase in the liability for leave encashment.
- The **extent of impact** on liability will differ from Company to Company, **based on Company's leave policy** (i.e. based on salary on which the leaves are encashed) and the **requirements of the Shops and Establishment Acts of the state(s)** in which the Company operates.
- One-off increase in the leave liability shall be **charged to Income Statement** in most cases.

**Liabilities of other post retirement and other long-term employee benefits may also increase**, in line with above.

# Fixed Term Employment: Vesting Criteria to not apply

- In case of Fixed Term Employment, gratuity pay-outs will be made upon the expiry of the fixed term, **irrespective of whether 5 years have been completed or not.** Calculation of gratuity benefit, in such cases, shall be done **on pro-rata basis**.

- This is expected to result in **increase in gratuity liability** in case of Companies that offer fixed term employment.

- The increase in liability because of this change **shall be treated as Past Service Cost and charged to Income Statement**, either immediately or over a period of time (depending upon the applicable accounting standard).

- Please refer to the next section for treatment of Past Service cost under different accounting standards.

***What is Fixed Term Employment?***

*As per Section 2, sub section 34 of the Code on Social Security, 2020, Fixed Term Employment means the engagement of an employee on the basis of a written contract of **employment for a fixed period**, provided that:*

*(a) his hours of work, wages, allowances and other benefits shall not be less than that of a permanent employee doing the same work or work of a similar nature and*

*(b) he shall be eligible for all benefits, under any law for the time being in force, available to a permanent employee proportionately according to the period of service rendered by him even if his period of employment does not extend to the required qualifying period of employment.*

# Vesting for Journalists: Reduced to 3 years from 5

- Gratuity is payable to an employee on the termination of his employment after he / she has rendered continuous service for not less than five years.

- However, for **working journalists**, the Code on Social Security, 2020 **reduces the vesting criteria from five years to three years**.

- This shall result in an **increase in liability for the Companies in the News and Media industry** i.e. the Companies that employ working journalists.

- The increase in liability because of this change **shall be treated as Past Service Cost and charged to Income Statement**, either immediately or over a period of time (depending upon the applicable accounting standard).

# Let us go into break out rooms and discuss…

## In the break out room

- ✓ **Unmute yourselves** so you can exchange views
- ✓ First **choose a speaker**, who will collate all points and speak later in the Webinar
- ✓ **Discuss the assigned questions**. Collate all thoughts, including views and counter views
- ✓ Chosen speaker to **prepares points to speak** for 4 to 5 min after the break out sessions get over

## When back from break out rooms

- ✓ The chosen speaker will be **asked to share views** of the group
- ✓ The chosen speaker will be asked to **Unmute** to be able to speak
- ✓ **Stick to the time limit of 4 to 5 minutes**. Exceeding time limit will result in session being over-run
- ✓ Do **not answer any questions** raised (including on chat). Just report out the points discussed in the group.

# “Breakout Rooms”

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## Welcome Back – Report Out

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# Capacity Building Webinar on Retirement Benefits Online
5th February 2021

## Social Security Code – Closing Remarks

**Arpan Thanawala**

**FIA, FIAI**

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# Social Security Code, 2020

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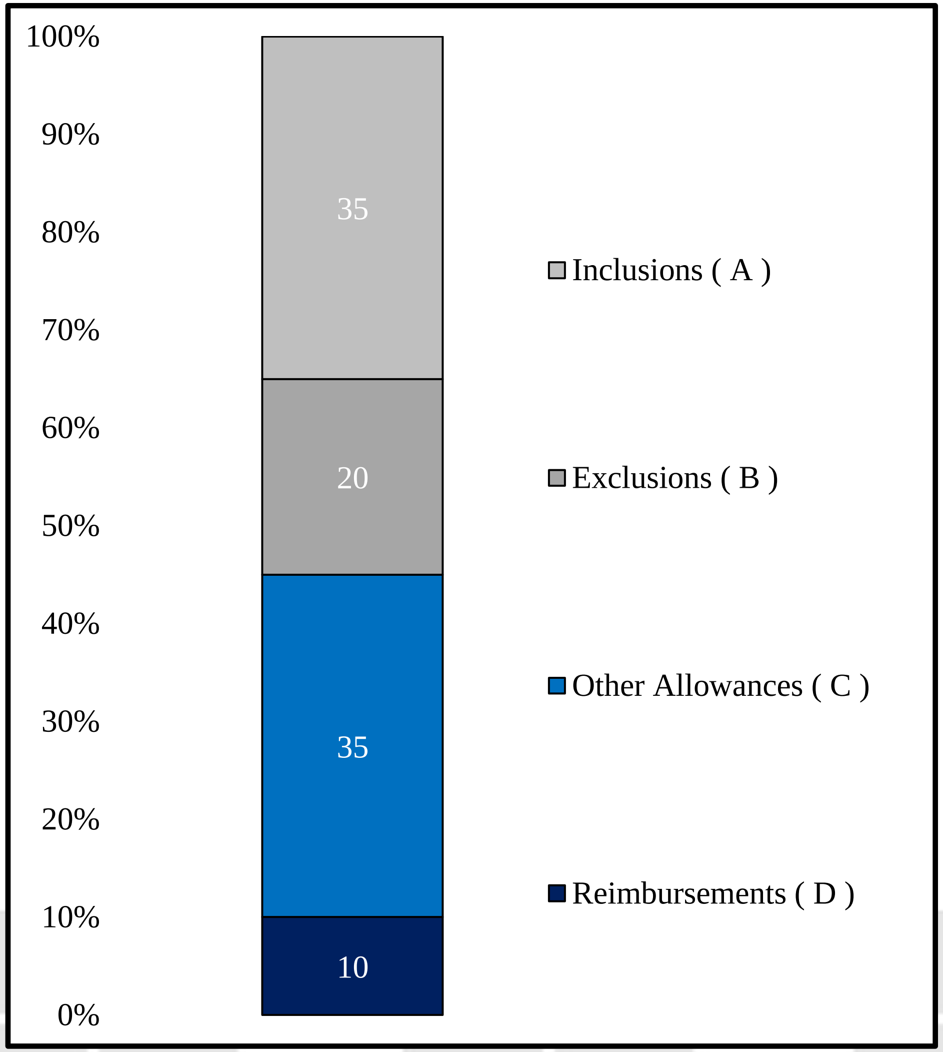
| Change in Wages Definition | Mandatory Funding Requirements | Fixed-Term Contract Employees |
|---|---|---|
| • Gratuity Salary changed from Basic + DA<br>• Now based on **all remuneration** except certain exclusions<br>• Change likely to come into effect from 1st April 2021 | • Mandatory from a date to be specified in the future<br>• Funding to be done through an insurance company<br>• Impact only for unfunded schemes<br>• Large cash outflows for funding | • No vesting period for fixed-term contract (FTC) employees<br>• Indirect cost of FTC employees who are on consultants' payroll<br>• Need to allow for gratuity liability for direct FTC employees |

# Revised Wages Definition




*Examples*

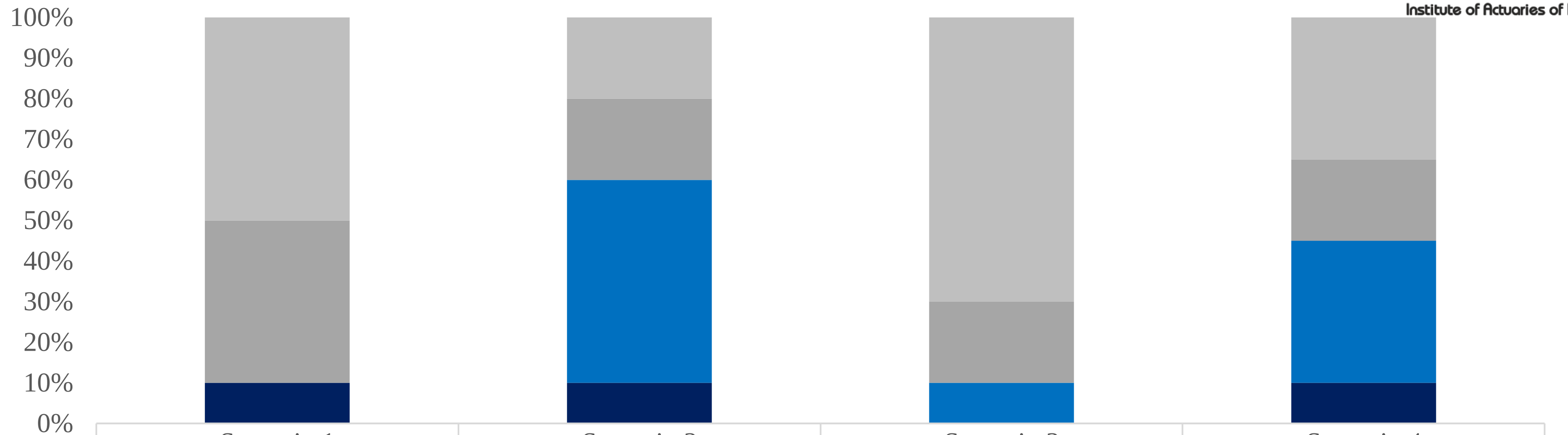
Inclusions: Basic, Dearness Allowance, Retaining Allowance
Exclusions: HRA, Overtime, Commission, Bonuses
Other Allowances: Supplementary / Special Allowance
Reimbursements: Reimbursements for travel, meals etc.

Wages used for calculating gratuity under Social Security Code, 2020:

*A + Excess of B over and above 50% of total CTC + C*

*Clarification sought regarding which components of D are to be included*

# Compensation Structures




| | Scenario 1 | Scenario 2 | Scenario 3 | Scenario 4 |
|---|---|---|---|---|
| Inclusions ( A ) | 50 | 20 | 70 | 35 |
| Exclusions ( B ) | 40 | 20 | 20 | 20 |
| Other Allowances ( C ) | 0 | 50 | 10 | 35 |
| Reimbursements ( D ) | 10 | 10 | 0 | 10 |

Ideal comp. structure

No impact

High proportion of allowances

20% => 70%

High proportion of inclusions

70% => 80%

Usual comp. structure

35% => 70%

# Who will be impacted most?

- Basic Salary low as % of total remuneration
- Large proportion of employees with high past service
- Companies providing gratuity benefits without a ceiling
- Companies having a higher accrual rate than prescribed under the Gratuity Act
- Large proportion of FTC employees
- Companies with unfunded gratuity plans

# Implications of the Code

- Large P&L Impact for Employers
- Restructuring of Compensation Packages
- Increased administrative workload for calculating gratuity
- Employers may move towards minimum statutory benefit
- More employees are likely to hit the ceiling of 20 lakhs:
  - Liability less sensitive to salary growth rate but more sensitive to attrition rate
  - Higher impact when ceiling is further revised above 20 lakhs
- Employees' take-home salary will reduce
- Employers may cut-down on other non-statutory benefits

# Open Issues

- Clarity on what is to be included / excluded as per new wages definition eg. ESOPs, Sodexo vouchers, reimbursements

- Will the new wages definition be extended to leave encashment?

- Assuming notification date of 1st April 2021, will the impact be taken in FY 2020 – 21?

- Confirmation that wage ceiling limit of INR 15,000 will continue for PF

- Notification date for mandatory funding?

- Minimum funding rules for mandatory funding?

- Transition arrangements for funding of gratuity benefits?

# Thank You

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## CPD Question then see you at 3pm!

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