Puducherry Electricity Department

Report on Terminal Benefits Trust

March 2010

Report on Terminal benefits Trust

©2010 KPMG Advisory Services Pvt. Ltd., the sub-licensee of KPMG, the Indian member firm of KPMG International, a Swiss cooperative. All rights reserved.

Document review and approval

Revision history

Version	Author	Date	Revision

This document has been reviewed by

	Reviewer	Date reviewed
1		
2		
3		
4		
5		

This document has been approved by

	Name	Signature	Date reviewed
1			
2			
3			
4			
5			

Contents

1 Background 3

2 Actuarial valuation 4
2.1 Single v/s Multiple Trusts 4
2.2 Funding Options 5
2.3 Provident Fund for Existing Employees 5
2.4 Other Liabilities (Pension, Gratuity and Leave Encashment) for serving employees 5
2.5 Payment mechanism 6
2.6 *PESCO/GoP issues bonds to single Master trust* 6
2.7 Recommendation: 7

1 Background

The erstwhile Puducherry Electricity Department (PED), being a government department, has not made any provisions with respect to the employee's dues pertaining to the terminal benefits such as Pension and Gratuity. As per prudent commercial practices as well as to comply with statutory provisions of the Companies Act, 1956, provision for these has to be made every year based on actuarial valuation and these provisions should be invested in approved securities and, along with return on such investments should be adequate to meet the terminal benefit payment requirements of the employees. PED has been meeting payment requirements from the government on a Pay as You Go basis.

Under the power sector reform programme undertaken by the Government of Puducherry (GoP), PED has been corporatized and unbundled into the Puducherry Electricity Supply Corporation (PESCO) and Puducherry Electricity Transmission Corporation (PETCO) with effect from April, 2010.

The objective of the reform programme is to create financially viable and self-sustaining organisations that would be managed on sound commercial footing. To achieve these objectives several anomalies that existed in the past need to be corrected. One of the major apprehensions that the employees have is the security of payment of terminal benefits to which they were entitled while they were employees in the erstwhile PED. Protecting such terminal benefits is also a statutory obligation under the terms of the Electricity Act, 2003. This report addresses the issue of estimating the unfunded employee dues, creating trusts to manage the liabilities and options for funding the trusts.

2 Actuarial valuation

The extent of unfunded employee liabilities on account of terminal benefits other than PF[1] i.e. pension and gratuity has been arrived at by actuarial valuation completed as at July 01, 2009. The actuarial valuation has been done to include all the employees. Certain assumptions have been made with respect to the pay fixation, dearness allowance, annual increase in salary / pension etc. Based on these assumptions, the initial fund size for unfunded employee liabilities has been estimated at Rs. 213.21 crores by discounting the future cash outflows @ 10%. This includes the Pension, Gratuity and Leave encashment liabilities of existing service personnel.

However, a second actuarial valuation, carried out by SBI Caps, with latest employee data (including DA rise and latest pay scales, computed at 7.5% discount rate) puts the valuation at ~ 257 Crore. The Government may choose to follow one of the above valuations and fund the trust accordingly. The document assumes adoption of the 213.2 Crore valuation.

2.1 Single v/s Multiple Trusts

It is a statutory requirement to establish separate trusts for Pension & Gratuity payments and PF liabilities. Further each of the successor companies being separate corporate legal entities would be required to maintain separate employee trusts under the Companies Act. Hence the option to be evaluated is whether a single trust could adequately serve as a transition mechanism based on the following issues:

Appropriating and allocating credits to the fund:- In case of a single trust, an appropriate mechanism will have to be devised to ensure that credits to the trust fund account on account of interest and / or other revenue (i.e. credits other than the contributions that would be made by the these companies) are accurately appropriated amongst successor companies. This appropriation and allocation will have to be determined on the basis of some formula that determines the proportionate sharing amongst the companies. Such formula may have to be dynamic and may require periodic review. Perhaps the most obvious basis would be to determine the proportions based on the number of personnel for each company. However, if the companies default in their payments to the trust then the defaulting company cannot be entitled to receive a proportionate credit in the manner above. This may be a complex exercise since the numbers of the personnel would keep changing constantly and it may not be an easy task to accurately track the proportions. Further complexities might arise in case one or more of the participating companies alter their pension scheme. In such a case the allocation formula would not be applicable to the said company(ies).

Income Tax Approvals:- The PF and Pension Trust have to be approved / recognised by the Income Tax authorities to ensure that the contributions to such trusts made by the companies/employees are tax deductible. Without such Income Tax recognition the companies and/or personnel would not be allowed to deduct these contributions as a legitimate business expense in their P & L accounts and/or get income tax benefit in the hands of the employees. Therefore, if single common trusts are proposed, then this trust would require to be approved by the Income Tax authorities to recognise contributions from the all the successor companies. Ordinarily, such income tax approval/recognition

is a cumbersome process and takes several months. Therefore, if as stated in (a) above, ultimately separate trusts need to be established, then it is desirable to establish separate trusts for each of the successor entities.

Convenience to employees:-. The option chosen should offer convenience to employees for receiving terminal benefits. The employees should receive their payments from a single entity and should not have to deal with multiple agencies. This is particularly applicable to those employees, who would have rendered service to one of the successor entities prior to the effective date and would retire from a different entity in future. While a single trust would offer this convenience, it would have the disadvantages discussed above.

Transfer scheme:- The transfer scheme is provisional in nature and the final transfer scheme will be designed and implemented at the appropriate time taking into account the repatriation of ministerial employees and capability development of employees in Transmission and Distribution space.

Hence it is recommended that a single trust be set up initially and this may continue till final transfer scheme is drawn out.

2.2 Funding Options

The most desirable alternative for funding the employee liabilities is to either deposit cash or retain the liabilities with GoP. The proposal for funding of liabilities is under consideration by GoP. In absence of cash resources either with the utility or with the GoP, the most feasible solution for financing the employee trusts is to develop financial instruments in form of debt, issued by. say GoP to the trust. The instruments would be redeemed over a long maturity period and would be structured so as to meet the annual payment requirements by the trusts. The Financial Restructuring Plan submitted assumes a 15 year bond raised by GoP to finance the trust. The employee liabilities have been recognised as per the actuarial valuation report and may be allocated to GoP. This implies that GoP would be responsible for issuing these instruments and servicing the liability. The Government has received the proposal of accepting employee liabilities favourably and is in advanced stages of finalization of the same

2.3 Provident Fund for Existing Employees

The provident fund balance of PED employees (on actuals) shall be transferred to the PF trust set up by the successor entities.

2.4 Other Liabilities (Pension, Gratuity and Leave Encashment) for serving employees

Since this fund is related to the employees that are still in service, this liability is estimated on the basis of increments, the projected increase in DA, annual increments, and pay revisions on a reasonable basis and

not on last salary. The initial estimate of fund size would change based on the changes in the pay structures, pay revisions and other factors. Consequently the projected annual payment requirements for meeting the terminal benefits for future retirees would also vary. The financial instrument(s) for funding these liabilities should capture this variable nature of these dues. Secondly, the liability is required to be structured as a basket of instruments of varying maturity and staggered repayment schedules so that servicing obligations do not come in a lump and cause tariff shock. To capture the varying nature of the dues the interest rate could be stipulated as floating over and above a particular base level and an annual adjustment in the rate can be carried out based on the overfunding / underfunding of the liability.

2.5 Payment mechanism

Based on the above recommendation to form a single trust and keeping in mind the convenience of the employees to receive payments from a single agency, the payment mechanism could be evolved as below:

Large number of the future retirees would have rendered service in the erstwhile PED, and thereafter retire from one of the successor companies. The funds accumulated for all the serving employees as on effective transfer date on account of terminal benefits have been estimated at Rs.213.21 crores (excluding PF) and shall be vested with PESCO/GoP as per the finalised terms of the transfer scheme. In such a scenario the payment obligation proportionate to their service rendered prior to the effective transfer date, rests with PESCO/GoP, balance being serviced by the entity from which the employee retires.

2.6 PESCO/GoP issues bonds to single Master trust

PESCO/GoP would primarily be responsible for the employee liabilities till the final transfer scheme. Thereafter, the terminal benefits liabilities of PESCO and PETCO would be calculated accordingly and appropriate arrangements would be made to contribute such funds into the Master Trust.

2.7 Recommendation:

It is recommended that a single master trust be set up and PESCO/GoP issues bond to the trust. After the final transfer scheme setting up of seperate trusts of the entities is much more desirable, as each company would establish its own trusts, obtain the necessary Income Tax recognition and make periodic contributions to the same. There would be no issue on the allocation of the interest and other revenues, nor would there be any issue with the Income Tax.

This structure is cleaner and potential disputes regarding management of trusts, allocation of funds, proportion and allocation of revenues etc. would not arise. In the end the companies must have their own trusts, and therefore, it may be desirable to start with a via media at this stage and transfer to the desired position. This structure combines the advantages of both the concepts viz. a single master trust and splitting of liabilities as detailed above and serves as a more amenable approach. Before implementing any of the above options the company is advised to take a comprehensive legal opinion on the same.