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Phone No.26189061
EMPLOYEES' PROVIDENT FUND ORGANISATION
(Ministry of Labour, Govt. of India)
Head Office
Bhavishya Nidhi Bhawan, 14, Bhikaiji Cama Place,
New Delhi - 110 066

No.Invest.I/1(75th)F&I Meeting/2003

Dated 30.1.2004

To

All Members,
Finance & Investment Committee,
Employees' Provident Fund.

Sub: Agenda Papers for the 75th meeting of the Finance & Investment Committee, Scheduled to be held on in the Central Office, State Bank Of India,(Domestic Treasury Department), Madame Cama Road, Near Vidhan Shabha Building, Mumbai-400021 on Friday the 6th February,2004.

Sir,

In continuation of this office letter of even no. dated 19.1.2004 on the captioned subject, it is informed that the 75th meeting of the Finance & Investment Committee will be held on Friday the 6th February,2004 in the Central Office, State Bank Of India,(Domestic Treasury Department), Madame Cama Road, Near Maharashtra Vidhan Shabha, Mumbai-400021 Agenda booklet for the said meeting is enclosed.

You are requested kindly to make it convenient to attend the meeting.

This issues with the approval of FA & CAO.

Yours faithfully,


(K.L.TANEJA)

REGIONAL COMMISSIONER (INVEST.)

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Item No. 1 : Confirmation of the minutes of 74th meeting of the Finance & Investment Committee held at New Delhi

Minutes of 74th Committee were circulated vide letter No. Invest.I/1973)/F&I meeting/2003/17605-17 dated 12-12-2003. Copy of minutes is enclosed (**Annexure 'A'**).

Comments of FA (Labour) received vide letter no. U-16013/21/2003-Fin-II dated 8-12-2003 (copy enclosed), **Annexure 'B'** on the said minutes.

The committee may, therefore, confirm the minutes of the 74th meeting.

DRAFT MINUTES OF THE 74th MEETING OF THE FINANCE AND INVESTMENT COMMITTEE, CENTRAL BOARD OF TRUSTEES. EMPLOYEES' PROVIDENT FUND HELD ON 02.12.2003 AT NEW DELHI.

The 74th meeting of the Finance and Investment Committee, Central Board of Trustees, Employees' Provident Fund was held on 2nd December, 2003 in New Delhi at 12.30 p.m. The meeting was chaired by the Additional Secretary (Labour), Govt. of India.

The following were present:

Shri J.P. Chowdhary, Member
Shri Ram Tarneja, Member
Shri A. Venkatram, Member
Shri Sanjay Singh, Controller of Accounts on behalf of Smt. Rama Murali, JS & FA (Labour), Member
Shri Anirudh Rai, Convenor

Shri Ajai Singh, Central Provident Fund Commissioner, Shri A. Vishwanathan, Addl. Central Provident Fund Commissioner (Pension) and Shri C.M. Pillai, D.G.M., State Bank of India also attended the meeting as special invitees.

At the outset, the Chairman welcomed the members and special invitees to the meeting.

Item No.1: Special audit report for the period 1.10.2000 to 31.03.2001 and for the year 2001-02 on investment portfolio of Employees' Provident Fund Organisation managed by the State Bank of India.

Aforesaid Audit Reports were circulated earlier. The item was deferred with an advice to get the comments of SBI on the remarks of EPFO given against the remarks of Auditors and SBI in the gist of Audit Report. SBI should be asked to report about the reasons for keeping the idle funds.

Item No. 2: Confirmation of the minutes of the 73rd meeting held on 14.10.2003

The Committee confirmed the minutes of its 73rd meeting held on 14.10.2003.

Item No. 3: Statement showing the action taken on the recommendations of the Committee

Item No. 3(1): Outstanding Interest and Maturity proceeds

The Committee noted the contents.

Item No. 3(2): Extracts of concurrent Audit Reports to be furnished by the State Bank of India

The Committee noted the contents.

Item No.3(3) : Idle Funds:

The Committee noted the contents.

Item No.3(4): Study paper by State Bank Of India in view of the precarious financial position of many State Government Guaranteed issuers and presentation by SBI regarding requisite amendments in the existing investment pattern and guidelines.

The Committee noted the contents.

Item No. 3(5): Default by HMT Limited

Committee was informed that HMT Ltd. is a defaulter in payment of provident fund dues in addition to the non-payment of outstanding interest and principal on 16% HMT Bonds, face value of Rs.25 crores. HMT Ltd. is going to sell its property in Bangalore. Regional Provident Fund Commissioner, Karnataka be advised to attach all the properties and recover the provident fund dues.

Item No.3(6) : Declaration of rate of interest for EPF subscribers for the year 2003-04.

Committee noted the contents and desired to put up an item about declaration of rate of interest after considering actual earnings of previous year instead of projected earnings of relevant financial year.

Item No. 3(7): Actuarial Valuation of staff pension cum gratuity fund

Committee noted the contents.

Item No.3(8): Study for identifying new avenues for investments and investment guidelines

Committee decided as under:

- In the selection criteria it may be added that consultancy firms working as Investment Banks can also apply but managers of the fund portfolios should not be able to apply for this tender. However, the firm to be selected as consultant for doing the study should not be able to bid for portfolio management services in future.
- Open tender should be invited at the earliest and the advertisement be given in 'The Economic Times' and 'Hindustan' (Hindi). For giving the advertisement expenditure up to 1 lakh can be incurred through DAVP. Details about the tender may be placed on EPFO's website.
- In the advertisement the prospective bidders should be given two weeks time to submit the bids.
- Committee of following officers be constituted to process the bids and place before the competent authority.

Shri Anirudh Rai, FA& CAO

Shri Sanjay Singh, Controller of Accounts, or any other representative of Joint Secretary/Financial Advisor, Ministry of Labour

Shri K.L. Taneja, RPFC (Investment)

Item No. 3(9): Proposal of IFCI for roll over of dues payable to CBT, EPF.

The committee noted the contents.

Item No. 3(10): Study regarding fund flows.

The committee noted the contents.

Item No.3(11): Portfolio management of Central Board of Trustees, Employees' Provident Fund, charges payable to SBI for the year 2003-04.

SBI be advised again to reconsider and reduce the transaction fee from Rs. 0.03 per Rs.100/- to Rs 0.02 per Rs 100 on Face value of every investment other than in Special Deposit Scheme. SBI may also be advised to reduce the existing cap of Rs. 20,000/- to Rs. 10,000/- on the transaction fee recovered on individual face value of investment (Deal ticket wise) irrespective of the amount invested under this deal ticket. Further SBI be advised to reduce the Income Collection fee on Non-SGL securities from Rs. 0.05 per Rs. 100/- to Rs. 0.04 per Rs. 100/-.

Item No. 4: Review of Investments

The Committee noted the contents.

Item No.5: Review of Investment Pattern and guidelines

The D.G.M., State Bank of India made a detailed presentation emphasizing the need to change the Investment Pattern and the investment guidelines. The Committee decided to defer the matter so that the members can give their considered opinion and valuable suggestions.

Item no. 6:- Revised Estimates for the year 2003-04 and Budget Estimates for the year 2004-05 for the Employees' Provident Fund Scheme, 1952, Employees' Pension Scheme, 1995 and Employees' Deposit Linked Insurance Scheme, 1976

The Committee recommended that the Budget proposals be placed before the Central Board of Trustees, Employees' Provident Fund, in its meeting scheduled for 03.12.2003 along with following details:

- An increase of 25 crores and 20 crores has been sought in the revised estimates for the year 2003-04 under the heads Pay of establishment and D.A. respectively as compared to actual expenditure of previous year. It should be worked out how much increase is on account of normal increments, increase in staff and on account of DA hike.
- As compared to the actual expenditure of 4.16 crores under the head computerization in the year 2002-03, Rs.85.24 crores and Rs. 242.06 crores has been sought under the Revised Estimates for the year 2003-04 and Budget Estimates for the year 2004-05 respectively. Details of the expenditure under the head computerization be placed before the CBT, EPF.
- As against actual revenue expenditure of Rs.373.51 crores during the year 2002-03, Rs.540.86 crores have been sought under the Revised Estimates for the year 2003-04. It reflects an increase of more than 40% over the previous year. Details about variation be placed before the CBT,EPF.

The meeting ended with a vote of thanks to the chair.

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ANNEXURE - B
Item No. I

No.U-16013/21/2003-Fin.II
Government of India/Bharat Sarkar
Ministry of Labour/Shram Mantralaya

New Delhi, dated 8th December 2003

To

Ajai Singh
Central Provident Fund Commissioner
Bhavishya Nidhi Bhawan
14, Bhikaji Cama Place
New Delhi- 110066.

PS to CPFC
* RECEIVED ON *
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Subject: 46th Meeting of the Executive Committee (EPF) & 74th Meeting of the Finance and the Investment Committee, both held on 2nd December 2003.

PA

Sir,

The aforesaid meetings, on my behalf, were attended by Shri Sanjai Singh, Controller of Accounts, Ministry of Labour. I am informed that some decisions have been taken in the meeting. I would like to express my reservation on the following items:-

Executive Committee (EPF)

Item No.5: Acquisition of land for construction of office building for SAO Jalandhar.

A plot of land of 1590 Sq.yds. at Ladowali Road, Jalandhar is proposed to be purchased from Punjab Urban Development Authority (PUDA) @ Rs.9000 per Sq.yd., with the total cost of Rs.1,43,10,000/-. This item was submitted to the Executive Committee, as the next meeting of Sub-Committee for Building and Constructions was not scheduled in near future. The Executive Committee approved an amount of Rs. 1,43,100, being 1% of the total cost to be released to PUDA as the amount was supposed to be given to them before 31st December, 2003 to avail the present rate which is due for revision from 1st January 2004. The Committee desired that the proposal should come through Sub-Committee for Building and Construction. I may mention that if the amount of Rs. 1.43.100/- is released to PUDA, we would be making a commitment to purchase the land before assessing the need for it. The agenda item did not give the cost benefit analysis nor did it provide adequate justification for purchase of the plot of land, which seems to be quite costly. Therefore, it is necessary that before giving any commitment by

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releasing one percent of the cost the plot of land to PUDA, cost benefit analysis should be done along with reasonability of rates.

Finance and Investment Committee

Item No.3: Action Taken Report

Under Serial No.9 of the item, for selection of consultant to identify new avenues for investments of EPFO corpus and investment guidelines, the committee decided to form a sub committee to shortlist the prospective consultants who would apply in response to the tender to be issued by EPFO. The name of Shri Sanjai Singh, Controller of Accounts, MOL was also proposed as one of the members for such sub-committee. In my view no representative of the Finance Division of the Ministry of Labour need to be included in such sub-committees. Therefore, I request that the name of Shri Sanjai Singh may be excluded from the sub-committee.

I request that the Chairman of the Committees may kindly be apprised of my views as stated above.



RAMA MURALI
FA(Labour)

Item No. 2: Review of Investment Pattern

- I. Investments of the fund administered by the CBT,EPF are made in accordance with the investment pattern notified under para 52 of EPF Scheme, 1952 and the investment guidelines laid down by the Central Board of Trustees, Employees' Provident Fund. The pattern of investment and the investment guidelines need to be reviewed from time to time in accordance with the changes in economic environment. Extant investment pattern notified by the Ministry of Labour on 09.07.2003 is reproduced below: -

INVESTMENT PATTERN

Percentage amount
to be invested

(i)	Central Government Securities as defined in Sec. 2 of the Public Debt Act, 1944 (18 of 1944); and /or units of such Mutual Funds which have been set up as dedicated Funds for investment in Government securities and which have been approved by the Securities and Exchange Board of India;	25%
(ii)	(a) Government Securities as defined in Sec. 2 of the Public Debt Act, 1944 (18 of 1944); created and issued by any State Government; and/ or units of such Mutual Funds which have been set up as dedicated Funds for investment in Government securities and which have been approved by the Securities and Exchange Board of India; and /or (b) Any other negotiable securities the principal whereof and interest whereon is fully and unconditionally guaranteed by the Central Government or any State Government except those covered under (iii) (a) below	15%
(iii)	(a) Bonds/ Securities of 'Public Financial Institutions' as specified under Section 4(1) of the Companies Act; "public sector companies" as defined in Section 2(36-A) of the Income Tax Act, 1961 including public sector banks; and /or (b) Short duration (less than a year) Term Deposit Receipts (TDR) issued by public sector banks	30%
(iv)	To be invested in any of the above three categories as decided by their Trustees.	30%
(v)	The Trusts, subject to their assessment of the risk - return prospects, may invest up to 1/3 rd of (iv) above, in private sector bonds/ securities, which have an investment grade rating from at least two credit rating agencies.	

2. Any moneys received on the maturity of earlier investments reduced by obligatory outgoing shall be invested in accordance with the investment pattern prescribed in this Notification.
3. In case of any instruments mentioned above being rated and their rating falling below investment grade and the same rating has been confirmed by two credit rating agencies then the option of exit can be exercised.
4. The investment pattern as envisaged in the above paragraphs may be achieved by the end of a financial year, and shall come into force with immediate effect.

II. Constraints that Provident Funds live with: -

The traditional investment avenues prescribed in the pattern of investment notified by the Central Government are losing their significance after liberalization and globalization of the Indian economy and the resultant soft interest rate regime. The Fund Managers are hard pressed. They are trying their best to match the expectations of the Provident Fund subscribers but they are facing serious problems in their endeavour. The bigger Provident Fund Trusts are somehow managing to give reasonable returns to their subscribers but the problems are more acute with the smaller Provident Fund Trusts who do not have the backing of professional Fund managers. It would be appropriate to discuss the problems being faced by the Provident Fund investment managers in the current scenario of debt market in the country in order to underline the urgent need of finding out alternative and safe avenues for investments.

• Soft interest rate regime

The PF Trusts had no problems when the interest rates were as high as 12-13%. The interest rates have consistently fallen in the last 3-4 years under all categories of investments. The yield on AAA bonds of Public Sector Undertaking/Public Sector Financial Institution (PSU/PSFI) category has come down from 13% to 6%. The yield on 10 year Govt. Securities and State Development Loans has come down to approximately 5.2% from 12%. If the inflation rate goes up, the yield on 10 year Govt. Securities may even become negative. The soft interest rate regime, which is expected to continue for some more time, has adversely affected the performance of the PF Trusts.

• Lack of Investment Avenues

As per the pattern of investment 30% of the fresh accretions to the Funds has to be invested in the bonds of Public Sector Undertakings/Public Sector Financial Institutions. In the liberalized economic scenario, the Public Sector Financial Institutions have crumbled and there is very little scope for investment in their bonds. The financial health of IDBI, IFCI are well known. With the dis-investment of blue chip Public Sector Undertakings, avenues of

investment in this category have squeezed. This avenue will further shrink with the privatization of oil majors viz. HPCL, BPCL, IBP, IOC etc. All PF Trusts are experiencing the dearth of good quality (AAA rated) instruments of PSU/PSFI category in the market.

Further, the State Govt. guaranteed papers, floated by State Govt. Corporations, have lost their significance as no PF Trust wants to invest in them even though they offer higher rate of return. The financial health of these Corporations is in a bad shape and as such high risk is associated with these investment decisions. Since most of the State Govts' finances are in bad shape, there are no takers for these State Govt. Guaranteed Securities.

- **Increasing Defaults**

In recent years, it has been noticed that some of the important issuers (Public Sector Undertakings, State Govt. Guaranteed issuers etc.) have started defaulting in servicing the interest as well as Principal. Many of the State Governments, as pointed out earlier, are having very poor financial health and as such their Public Sector Undertakings are defaulting in payment of interest/redemption amount for want of budgetary support. Some of the borrowers have unilaterally reduced the contracted rate of interest. This is against the contractual provisions but PSUs are adopting this mechanism which is detrimental to the interest of the PF Trusts.

- **Inadequate Judicial remedy**

For enforcing the borrower to service interest/principal, the PF Trusts have to take recourse to invoking the guarantees or to take legal recourse in the Court of Law. None of these methods produces positive results immediately. The legal battle is a long drawn process and requires expenditure of considerable amount of good money towards recovery of bad debt. The legal battle may continue for a long time and may end as an infructuous exercise due to extremely poor financial health of the borrower and the debt being unsecured debt. The PF Trusts also require some effective mechanism to recover their investments expeditiously.

- **Inflexible Investment Pattern and lack of active management**

The investment pattern notified by the Central Govt. is quite rigid and inflexible. The securities/bonds in which investments are made, are supposed to be held till maturity. The PF Trusts cannot offload the securities that are likely to be rated below the investment grade. The limited option provided in the investment pattern does not provide adequate opportunity to the investment manager for exit till rating of the securities has fallen below the investment grade and the same has been confirmed by the two credit rating agencies. After down-grading of rating either the security will become

illiquid or it will incur substantial loss on sale. The PF Trusts need the option of active management of their portfolios. When the Sector is being opened for competition, the existing PF Trusts should also be given liberty to churn out their portfolio to maximize their yield.

- **Exit route for mutual funds**

The Central Govt. has allowed investment in units of mutual funds setup as dedicated funds for investment in Govt. Securities. These mutual funds do not give annual returns to the investors. The method of income recognition on these investments and the exit route on the basis of net asset value (NAV) from these gilt based mutual funds need to be clarified.

- **Deposits in Special Deposit Scheme**

The Central Govt. had formulated the Special Deposit Scheme in order to help the PF Trusts get reasonable return on their investments. From April, 1997 fresh deposits in this scheme was stopped by the Govt. From the current year, the Govt. has further stopped reinvestment of the interest on the deposits in the Scheme. This has serious consequences for the PF Trusts. The market players are taking undue advantage of the inflexible investment pattern to be followed by the PF Trusts as they know pretty well that the PF Trusts have to invest the interest income from SDS in the market. The Ministry of Finance is also considering repayment of SDS deposits in terms of dated Govt. securities. If this decision is implemented the PF Trusts will have to depend heavily on the market forces which will take undue advantage of their vulnerable position causing heavy financial losses to the PF Trusts.

- **New Avenues For Investments**

Efforts should be made to find out new avenues for investments for PF Trusts, such as, securitised papers, multi-lateral bonds issued by the World Bank/ADB etc., Overseas investments, investments in AAA rated private sector bonds, etc. Some brain-storming is needed to suggest a roadmap for investments by PF Trusts by absorbing the national and international best practices of the industry. While recommending the roadmap for investments, utmost care should be taken to include only safest investment avenues as no chances can be taken with retirement money of millions of employees in the country.

- **Other constraints**

Compulsory minimum investment in various categories including investment of 30% of fresh accretions in PSU/PSFI category inspite of disinvestments drive.

- Artificial embargo on trading in securities even though not provided in EPF & MP Act, 1952 and EPF Scheme, 1952.
- Fixed deposits for less than one year duration only fetches yield applicable for the slab 180 to 364 days only. Yield slab changes for 365 days onwards and Provident Funds has to suffer losses due to the wording - "less than one year" in the investment pattern.
- Ignoring yield factor while laying too much emphasis on safety aspect. Balancing in risk-return is must in low interest rates regime.
- Increasing defaults due to sluggish inadequate judicial remedies resulted in unilateral reduction of interest rates by UPSFC, IFCI, MKVDC.
- Pending amendment in EPF Act to arm recovery machinery of EPFO (Like banks) for recovery of defaulted amounts.
- Low volumes in State Government paper
- Liquidity in G-Secs is shifting and uneven
- Low credit quality paper does not trade
- Portfolio changes to take advantage of rate movements cannot be executed easily particularly by the exempted trusts as model rules for grant of exemption still provides for prior approval of concerned RPFC before sale of securities
- Constraints on immediate deployment of redemption proceeds

III. Need to Liberalize the Investment Guidelines

Some of the constraints listed above are aggravated as the Portfolio Manger, State Bank of India is facing difficulties to invest the money in the relatively safer securities with better yield due to certain existing guidelines of Central Board of Trustees, Employees' Provident Fund. Changes suggested by the SBI, views of EPFO and proposed decisions are placed at **Item No. 3** for consideration.

IV. Liberalisation of Investment Pattern

Investment pattern needs to be liberlised further in view of the squeezing investment avenues, declining yields and to overcome a few constraints listed above. Problems / constraints, related facts / views along with the proposed decisions are placed at **Annexure 'A'** for kind consideration of the Committee and for making recommendations to the Central Board of Trustees, Employees' Provident Fund and Central Government for amendment of EPF Scheme / revision of investment pattern.

Accordingly, the matter may be considered by the Finance & Investment Committee for making suitable recommendations.

Proposed changes in Investment Pattern/EPF Scheme & rules specified thereunder

Problem/ Constraint	Facts/views for Consideration	Proposed Decision
<p>1. Embargo on trading in securities to book profits, to avoid losses, to switch securities and to churn portfolio to reduce the risk.</p>	<ul style="list-style-type: none"> • There is no explicit bar on sale of securities under EPF Act, 1952. Even exempted trusts are allowed by RPFs to sell securities as per model rules. • Only revised investment pattern dated 9.7.2003, first time incorporated a provision to sell the rated securities in case of their rating falling below investment grade. It defeats the very purpose of granting permission to sell because after downgrading of rating, PFs can only sell securities at loss and they can never book capital gains. • Extant pattern of investment provides for investment in Gilt Funds which are actively engaged in trading of Government Securities thereby indirect trading is clearly permitted. • Most of the Gilt Funds are open-ended or with growth option only thereby making the exit route necessary. 	<p>1. Regarding Gilt Funds & Govt. Securities(Unrated) Ministry of Labour may be requested to take up the matter with Ministry of Finance to get a clarification on the following:</p> <p>(i) That clause '3' of investment pattern is not applicable on Govt. Securities and Gilt Funds being unrated.</p> <p>(ii) Following proviso be added in the investment pattern:</p> <p>Portfolio be divided in tradable and non-tradable categories. A small proportion (say 10%) of total portfolio at the end of preceding financial year can be treated as tradable and it can be used for active management. Provident Funds may be allowed to sell securities to book profits, switch securities and churn portfolio in case of Govt. Securities and Gilt Funds. Tradable portfolio of Govt. Securities should be marked to market and Gilt Funds be valued at NAV as at the close of Financial Year.</p>
	<ul style="list-style-type: none"> • CBT,EPF recommended in Sept.,2001 that switching option could be exercised for sale of Govt. Securities only when there was capital gain involved in the transaction. • RBI's Deputy Governor also advised Ministry of Labour vide D.O. dated March 8,2002 as under: 	<p>(iii) In accordance with revised conditions No.24(b) for grant of exemption, format for audited Balance Sheet and the information to be furnished in the report shall be prescribed by Employees' Provident Fund Organisation. While preparing this format prudential accounting norms should be considered for accounting of premium, income recognition, valuation of portfolio's accounting on the basis of the NAV of Gilt Funds and for</p>

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	<p><i>"Currently banks are allowed to earmark a portion of their investment as held for Trading which are used for active management. The investments held in this category are marked to market (MTM) on a monthly or more frequent basis and profits/losses are booked as a result of such MTM. To start with, for encouraging active management by PFs without undue risk, a specified small predetermined percentage of investment could be allocated for active management on the same lines as banks".</i></p> <ul style="list-style-type: none">• Government of India intends to develop debt markets and encourage the use of transparent screen based system of trading in all instruments. For using the electronic trading platform for Govt. Securities, Provident Funds are already using CSGL accounts and the Negotiated Dealing System (NDS) developed by Reserve Bank of India through their banks.• To start with, for encouraging active management by PFs without any risk, a specified small predetermined percentage of investment could be allocated for active management on the same lines as banks".	<p>treatment of capital loss/gains due to churning of portfolio /valuation. Declaration of interest out of corpus should not be allowed.</p> <p>(a) To avoid distribution of income out of corpus income from units of Gilt Funds should be recognized when realised. However, in case of Growth schemes of Gilt funds, lower of the two i.e. increase in NAV to the extent of yield on 10 years Government of India securities or increase during the year in NAV with reference to cost of acquisition/carried forward book value can be recognised as income. Provision for unrealised loss should be made at the end of the financial year. The investments held in this category are marked to market (MTM) on monthly basis /on the last day of financial year and losses are booked as a result of such MTM.</p> <p>(b) Incase of non-tradable securities premium paid on purchase of securities be amortized proportionately during the period from the date of purchase to the date of maturity. However in case of purchase of securities of discount, difference between purchase price and face value can be treated as income either entirely at the time of maturity or proportionately during remaining tenure of the security. Valuation of portfolio be done at lower the cost of acquisition of securities or market price as on the last day of the financial year. In case of unquoted tradable portfolio, valuation be done at the fair market price as on the last day of the financial year.</p> <p>(c) Employers of exempted establishments shall be made liable under the revised conditions for grant of exemption to make good the capital loss to the trust for both on account of losses during the financial year on account of sale transactions and on account of valuation of units of Gilt Funds on the last day of financial year on the basis of NAV.</p>
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		<p>(d) Capital gains earned during the financial year on account of sale transactions can be either utilized by the trusts for declaration of rate of interest at par with statutory rate declared under Para 60(1) of EPF Scheme, 1952 or may be transferred to interest equalisation Fund which can be utilized for the same purpose in future.</p> <p>(iv) Model rules for grant of exemption be amended so that Exempted PF trusts need not take prior permission from concerned RPFC for sale of securities out of tradable portfolio. However provision to take prior permission from concerned RPFC for sale of securities out of non-tradable portfolio will remain unchanged.</p>
<p>2. Unbridled investments up to 70% of fresh accretions in Gilt Funds.</p>	<ul style="list-style-type: none"> • Extant investment pattern allows investment in the units of Gilt Funds up to 70% of investible monies viz. 25% and 15% in place of Central and State Government Securities respectively and 30% out of residuary clause. • There are no limits about exposure of Provident Funds towards any individual Gilt Fund. Asset management companies mostly pertaining to private sector manage gilt Funds. Risk of default by Government is not there but operational credit risks and interest rates risks are there in case of investments in Gilt Funds. Solution to minimize the risks is diversification. Exposure limits to one Gilt Fund should not be more than a prescribed proportion of total portfolio or trusts' exposure to Gilt Funds. Prudentially investment pattern should provide for exposure limits as has been done for corporate sector bonds and debentures viz.10% of total fresh accretions during a financial year. Diversification by laying exposure limits is considered essential not only to reduce operations & credit risk but to avoid declaration of interest 	<p>2.It may be recommended to the Government to include following proviso in the investment pattern;</p> <p>“Provided that irrespective of the proportion of investments stated above, exposure of a trust to any individual Gilt Fund should not be more than 5% of its total portfolio at any time”.</p>

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	out of capital also.	
3. Transfer of past accumulations under Para 28 of EPF Scheme	<ul style="list-style-type: none"> In the event of cancellation of exemption, securities are transferred to the CBT, EPF at the price for which they were actually purchased or sure equivalent to such price Under Para 28 of the EPF Scheme, 1952. Para 28 of the Scheme was incorporated in 1958 when Provident Fund money was invested only in Government Securities/Government Guaranteed securities with least variations in the market price. With the introduction of Gilt Funds in the investment pattern dated 09.07.2003, it has become all the more important to be equitable and to recommend to the government for suitable amendment in the said Para 28. SBI will give its views while making presentation before the Committee. 	Government of India may be requested to amend Para 28 of the Scheme so as to give an option to the exempted trusts to either transfer the money fully or partly in cash or fully/partly in the form of securities valued at market price in accordance with the Income tax rules. It may also be provided that CBT,EPF will also have an option not to accept units of gilt funds while accepting transfer of securities at the time of cancellation of exemption.
4. Investment in small saving scheme e.g. POTDRs, NSCs etc.	<ul style="list-style-type: none"> NSCs and POTDRs do not constitute an avenue for investment by EPFO. These are not approved securities under the investment pattern and are not governed by the definition of pronote (Government security as per section 2 of Public Debt Act, 1944) as these are not transferable by endorsement. However, since the yield is higher in NSCs and POTDRs these can be considered as investment avenues. CBT,EPF had earlier suggested inclusion of these avenues in the pattern of investment. 	Provident Fund and Pension Funds are compulsory small savings of more than 3.5 crore families and deserve to make investments in NSCs and POTDRs. Government of India may be requested to incorporate NSCs and POTDRs in the investment pattern under PSUs/PSFI category.
5. Omission of clause relating to re-investment of interest	<ul style="list-style-type: none"> Clause relating to reinvestment of interest in SDS was not included in the revised investment pattern dated 09.07.2003. Interest amounting to Rs. 4260.37 crores will be due on 01.01.2003 on the holdings of CBT, EPF amounting Rs.53254.61 crores. Investment 	Government of India may be requested that reinvestment of interest on SDS in the SDS account be continued as provided in the investment pattern in vogue up to 31.03.2003 i.e. following clause may be added again in the investment pattern:

in SDS	<p>pattern is silent about reinvestment of interest on SDS. However, Ministry of Finance in its notification dated 01.05.2003 stated as under:</p> <p>"Central Government may make repayment of the outstanding balance under the Scheme through issue of dated Government securities to the subscribers of the Scheme for such amount and maturity as it may decide, in consultation with the subscribers".</p> <p>No further communication has been received from the Government in this regard.</p> <ul style="list-style-type: none"> • Exempted trusts have also made several representations that it is very difficult to get alternative investment avenues for reinvestment of interest on SDS. • SBI will give its views while making presentation before the Committee 	<p>" Interest received on the Special Deposit Scheme shall be invested in Special Deposit Scheme itself. Similarly interest received in other categories shall be reinvested in the same category.</p>
6. Period of TDRs less than one year	<p>Revised Investment pattern provides for investment in short duration (less than a year) TDRs issued by public sector banks. Accordingly interest at the rate applicable on the slab of 180 days to 364 days is received. Slab of interest rates changes in case of TDRs of 365 days or more. Thus Provident Funds suffer unnecessary losses.</p>	<p>Govt. of India may be requested to replace the words "less than a year" by "upto one year" in clause 1(iii)(b) of the extant pattern.</p>
7. CBLO as additional avenue for parking of funds to avoid idling of funds	<p>"Collateralised Borrowing and Lending Obligation (CBLO)", a money market instrument as approved by RBI, is a product developed by CCIL for the benefit of the entities who have either been phased out from inter bank call money market or have been given restricted participation in terms of ceiling on call borrowing and lending transactions and who do not have access to the call money market. CBLO is a discounted instrument issued in</p>	<p>Government of India may be requested to incorporate CBLO, an instrument issued by CCIL as an additional investment avenue in clause of 1(iii)(b) of the extant pattern and portfolio manager may be authorized to complete the requisite formalities.</p>

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electronic book entry form for the maturity period ranging from one day to one year. In order to enable the market participants to borrow and lend funds, CCIL provides the Dealing System through Indian Financial Network (INFINET), a closed user group to the Members of the Negotiated Dealing System (NDS) who maintain Current account with RBI and through Internet for other entities who do not maintain Current account with RBI.

Insurance Regulatory development Authority (IRDA) has also categorized CBLO as approved securities for life insurance as well as general insurance companies.

RBI has also permitted CBLO for the purpose of CRR and SLR.

Had Repo and CBLO been permitted, idling of funds could have been prevented as per SBI's letter dated 28.01.2004. However approval is required from Central Board of Trustees, Employees' Provident Fund, RBI, Ministry of Finance and Ministry of Labour.

A brief on CBLO is enclosed (**Annexure A-1**).

Brief regarding Collateralised Borrowing and Lending Obligation (CBLO)

1. What is CBLO?

CBLO is explained as under:

- An obligation by the borrower to return the money borrowed, at a specified future date;
- An authority to the lender to receive money lent, at a specified future date with an option/privilege to transfer the authority to another person for value received;
- An underlying charge on securities held in custody (with CCIL) for the amount borrowed/lent.

2. Eligibility:

Membership (including Associate Membership) of CBLO segment is extended to banks, financial institutions, insurance companies, mutual funds, primary dealers, NBFCs, Corporates etc. The Members are required to open Constituent SGL (CSGL) Account with CCIL for depositing securities which are offered as collateral / margin for borrowing and lending of funds. Also Associate Members are required to open a current account with a Settlement Bank designated by CCIL for settlement of funds.

3. Eligible Securities:

Eligible securities are Central Government securities including Treasury Bills with a residual maturity period of more than six months.

4. Borrowing Limit and Initial Margin:

Borrowing limit for the members is fixed everyday after marking to market and applying appropriate hair-cuts on the securities deposited in the CSGL account. The post hair-cut Mark-to-Market value after adjusting for the amounts already borrowed by the members is the borrowing limit, which, in effect, denotes the drawing power up to which the members can borrow funds. Members are required to deposit initial margin generally in the form of

Cash / Government Securities and initial margin is computed at the rate of 0.50% on the total amount borrowed/lent by the members.

5. Auction Market:

Auction market is available only to NDS Members for settlement on T+0 basis. Access to Auction market is not available to other entities. Based on the borrowing limits fixed by CCIL, members submit their borrowing requests to CCIL indicating clearly the amount, maturity and the cap rate before commencement of the auction session. i.e. from 10.30 A.M. to 11.00 A.M. Members are permitted to borrow and lend funds on overnight basis indicating the cap rate/s which is/are linked to a base rate (a cap rate is the maximum rate upto which the borrower is willing to pay).

Currently the permissible caps are:

- a) MIBOR
- b) MIBOR + 50 bps
- c) MIBOR - 50 bps
- d) No cap specified.

CCIL approves the requests of the members subject to availability of borrowing limit and places the same on the specified auction windows on behalf of the borrowing members. The lenders willing to lend place their bids directly on the respective auction window indicating the amount and the rate during the auction session which is open from 11.15 A.M. to 12.15 P.M. At the end of the Auction market session, CCIL initiates auction matching process based on Uniform Yield principle. The successful borrowers and lenders are notified well before the close of business hours regarding borrowing and lending of funds by them through the dealing system and the lenders who are allotted CBLOs in the Auction market are permitted to trade in such CBLOs in the Normal market from the subsequent day onwards.

6. Normal Market:

Normal Market is available to NDS Members for settlement on T+0 and T+1 basis and other entities can conclude the trades for settlement on T+1 basis. The Normal market can be accessed for borrowing funds to the extent of their available borrowing limit, besides members can sell CBLOs held by them to meet their funds requirement instead of waiting till maturity. Members intending to sell CBLOs (borrow funds) place their offers directly on the

market watch screen indicating the amount and rate for a specific CBLO. Like-wise, members willing to buy CBLOs (lend funds) place their bids specifying the amount and rate for a particular CBLO. The matching of bids and offers takes place on Best Yield – Time Priority basis. Normal market session is currently open from 9.00 A.M. to 3.00 P.M. on weekdays and on Saturdays from 9.00 A.M. to 1.30 P.M.

7. Risk Management:

CCIL addresses risk relating to trading and settlement by adopting strict membership norms by restricting its membership only to the entities which meet the minimum eligibility criteria. Members are allowed to borrow to the extent of the limit fixed after necessary valuation of securities with appropriate haircut. The securities in the CSGL account are subjected to daily valuation and any deficit in the value of the securities vis-à-vis the borrowed amount (face value of CBLO) is collected from the concerned members. Besides, CCIL stipulates initial margin for the lenders in the Auction market and for each bid and offer in the Normal market to address the interest rate risk, in case the lenders do not honor their commitments.

8. Regulatory Provisions:

The regulatory provisions as notified by RBI are as under:

- (i) **CRR:** In order to develop CBLO as a money market instrument, RBI has given a special exemption to the Banks from CRR for transactions in CBLO subject to the bank maintaining minimum CRR of 3%.
- (ii) **SLR:** Securities lodged by the bank in the CSGL Account of CCIL remaining unencumbered at the end of day can be reckoned for SLR purposes by the concerned bank.
- (iii) **Collaterals:** Securities in the CSGL Account of the participant for CBLO can be from any of the three investment categories viz., 'Held to Maturity', 'Available for Sale' and 'Held for Trading'. As the movement of securities from the SGL Account of a participant to CSGL Account with CCIL is done on value free basis, there is no transfer of ownership involved. Since the securities continue to remain in investment portfolio of the participant even when encumbered, there is no change in valuation of such securities.

- (iv) **Risk Weight:** Since CBLO is fully collateralised by government securities, the risk weight for market risk as applicable to government securities is applicable to CBLO.
- (v) **Accounting Norm:** The accounting treatment of CBLO is the same as applicable to any money market instruments / transactions.
- (vi) **Valuation:** CBLO outstanding on the date of balance sheet is valued on the same basis as discounted instruments of similar nature and tenor.

9. TDS Applicability:

Central Board of Direct Taxes, vide letter dated April 17, 2003, has clarified that the difference between the issue / cost price and the sale price / face value of CBLO is not in the nature of "Interest". In the light of the said clarification, the discount income earned on CBLO transactions is not subjected to TDS.

10. Advantages:

- i) CBLO market facilitates borrowers to effectively use the collaterals on the day of redemption of CBLOs to borrow funds.
- ii) Borrowers and lenders have the exit option before maturity of CBLOs.
- iii) No counterparty limits need to be fixed for lending under CBLOs as CBLOs are fully collateralized and CCIL acts as central counterparty.

11. Conclusion:

CBLO is a very safe alternative to inter-corporate deposits and call money with greater flexibility as compared to the existing Repo deals. The screen based trading provides transparency and maintain anonymity of the counterparties which is presently lacking in the money market operations. Trading in CBLOs provides opportunity for the members to efficiently manage their liquidity and facilitate price discovery. CCIL addresses the Settlement risk and provides guaranteed settlement.

GLOSSARY

Sr. No.	Terms	Description
1	Best Yield - Time Priority	Best Yield - Time Priority refers to the matching principle that the system follows in matching the offers with bids and vice versa. The Best Bid Yield for an Offer is the Bid yield which is equal to or less than the Offer Yield quoted by the borrowers. The Best Offer Yield for a Bid Order is the Offer Yield which is equal to or greater than the Bid Yield quoted by the lenders. If there are two or more identical Bid/Offer orders with the same Bid/Offer Yield, then the system follows the "Time Priority" principle based on the time of receipt of order by the system.
2	Close-out	Close-out is a process by which the CBLO shortfall quantity is distributed proportionately to members having net bought position in the concerned CBLO.
3	Hair-cut	Hair-cut is stipulated by CCIL to protect itself from potential losses arising on account of decline in market value of security held as collateral.
4	Initial Margin	Initial margin is collected to take care of the volatility in interest rates in case of default by the lenders.
5	Margin Call	Margin Call refers to the demand made by CCIL on a member to deposit additional funds and/or securities towards fulfillment of its margin obligation.
6	Mark-To-Market Margin	Mark-To-Market Margin refers to the shortfall in the mark-to-market value of the securities deposited by the borrowing members against their outstanding CBLO borrowings.
7	Member ID	Member ID refers to the Identification Code allotted to each member of CCIL to establish the identity. ID is unique to every member.
8	Obligation	Obligation refers to the contractual duty of the members to deliver and/or receive funds and/or CBLOs/Securities in terms of a trade on the

		settlement date.
9	Offer	Offer refers to an order for borrowing funds.
10	Bid	Bid refers to an order for lending funds.
11	Order Lot	Order Lot refers to the minimum amount that is required to constitute a successful trade on the trading system.
12	Trading/Dealing Session	Trading/Dealing Session refers to the market hours fixed by CCIL when members are permitted to conclude trades among themselves.
13	Uniform Yield	Uniform yield is the cut-off rate which is applicable to both the borrowers and lenders.
14	Volatility	Volatility is a statistical measure of a market or a security's price movements over time and is calculated by using standard deviation.
15	Volatility Margin	Volatility Margin is the extra margin which may be imposed by CCIL on both borrowers and lenders in the event of sudden increase in volatility of interest rates in the market.

Item No. 3: Review of Investment Guidelines

Portfolio yield is being unfavorably impacted due to market forces and the constraints of existing internal guidelines details of which are given in Item No. 2. Due to changes in the economic environment, a lot of internal guidelines needs review and modifications. It is considered essential to improve the yield in the soft interest rate regime, to avoid losses due to idling of funds and to increase the investment avenues. Good investment opportunities may not be enchased by the portfolio manager in the absence of appropriate modifications in the Internal Investment Guidelines.

Proposed modifications in the investment guidelines are given in Annexure - A for consideration by Finance and Investment Committee.

Proposed changes in Investment Guidelines

Existing Guidelines	Changes Suggested by SBI	Views of EPFO	Proposed Decision
1. Exposure to any PSU/PSFI/ Body corporate restricted to 25% of Net-worth.	The ceiling be increased to 35%	With growth of net-worth of top rated PSUs investment exposure limits also continue to grow. Similarly with the decline in profits resulting in fall of net-worth, exposure limits get reduced. It is prudent too. Keeping in view uncertainties in the market, diversification of investment is considered essential tool for risk management. Accordingly, existing exposure limits of 25% of net-worth may continue in case of PSUs other than banks. In case of Public Sector Banks ceiling may be increased from 25% to 30% as banks are supported and regulated RBI.	In case of Public Sector Banks exposure limits be increased to 30% of the net worth of the bank. Existing exposure limits of 25% of net-worth may continue in case of PSUs, PSFIs and other Body Corporates other than banks.
2. Maturity is restricted to 5 years.	The period to be extended to 15 years for AAA & AA+ categories	Government is disinvesting the PSUs and eventually PSUs are being converted into Private Sector companies. CBT, EPF had not even agreed for making investments in private sector bank bonds/debentures in past. However, keeping in view the shrinking investment opportunities in the public sector undertakings / PSFIs, the maturity period may be extended to 10 years for AAA rated PSUs/ PSFIs and 8 years for AA or AA+ rated PSUs / PSFIs.	In case of Public Sector Undertakings / PSFIs, the maturity period may be extended to 10 years for AAA rated PSUs / PSFIs and 8 years for AA or AA+ rated PSUs / PSFIs.
3. Exposure only to PSUs	This be extended to cover companies	If LIC Housing/PNB Housing/any other entity falls under PSU/PSFI category, portfolio manager can go ahead to make investments	Investments can be made by the Portfolio Manager in the subsidiary companies under the control of PSUs/

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	owned by PSUs (e.g. LIC Housing, PNB Housing etc.) and to papers guaranteed by top rated PSUs.	but follow the investment pattern & guidelines. As per Investment Pattern, Public Sector Co. means any Corporation established by under any Central, State or Provincial Act or a Government Co. as defined in Sec. 617 of the Companies Act, 1956. Section 617: For the purposes of this Act Government company means any company in which not less than fifty one percent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government, and partly by one or more State Governments, and includes a company which is a subsidiary of a Government Company as thus defined.	PSFIs. If such companies does not fall under the definition of PSU as defined under section 617 of the Companies Act, 1956 then, investments during the financial year should be restricted as per limits laid down in the Investment Pattern. Limits as per the extant investment pattern are: 10% of the fresh accretions during the relevant financial year.
4. PSU Bank Bonds with rating of AA and above.	No need for rating for Public Sector Bank Bonds. Private Sector/Foreign Bank Bonds of minimum AA rating may also be permitted.	To meet capital adequacy ratio stipulated by RBI, banks have to issue bonds which becomes part of their Tier-II capital.	Rating for Public Sector Bank Bonds may not be insisted if bonds/ issuers are not rated. However, in case of un-rated Public Sector Banks/ their Bonds, issuer banks' financial position should be sound and it should have earned profits in last 3 consecutive years preceding the relevant financial year.
5. No transactions with SBI and Associates.	This may be waived.	Restriction on dealing with SBI or its associates is a matter on which SBI has been requesting a review for quite some time. SBI claims that due to this restriction, almost 40% of the market gets excluded from the purview and they are unable to withstand market forces that leverage on this handicap. SBI has assured that they would put in place all the necessary	Market rate related dealings in Govt. Securities may be permitted with the subsidiaries of SBI and DFHI subject to special report by SBI justifying price, YTM, Market Low, Market High etc. in respect of security purchased and the other options considered by Investment Committee of SBI on that day. Further maximum cap be fixed as 10% of total

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		<p>safeguards to ensure that only market related rates would govern the transactions. If necessary, SBI would also report every such transaction separately, to impart total transparency to the process. SBI is managing the whole EPFO corpus on the one hand, and on the other hand even market rate related dealings are prohibited not only with SBI, but also with its Associates who are wholly independent entities.</p> <p>The prohibition of transactions with SBI does not deserve consideration for waiver except in case of TDRs. In principle Investment with oneself should be restricted/limited unless appropriate safeguards exists. However, with the subsidiaries of SBI and DFHI, claimed to be independent organizations, market rate related dealings may be permitted subject to special report by SBI justifying price, YTM, Market Low, Market High etc. in respect of security purchased and the other options considered by Investment Committee of SBI on that day. Further maximum cap can be fixed as 10% of total investments made during each month in respect of DFHI and other independent subsidiaries of SBI.</p>	<p>investments made during each month in respect of DFHI and other independent subsidiaries of SBI. Term Deposits with SBI and independent subsidiaries of SBI can be made provided the rate of interest is comparable with the rate of interest provided by the AAA rated Scheduled Banks.</p>
<p>6. No scope for investment in new debt products</p>	<ul style="list-style-type: none"> Securitized Debts where the recourse is on top rated PSUs like NTPC, IFFCO, IOC, etc. 	<p>Following views of SBI requires consideration:</p> <ul style="list-style-type: none"> most of the debt issues are rated AA+/AAA yield on securitised debt is usually 25-50bp over plain debts. <p>If required, SBI may elaborate the subject and explain the contractual obligations of the PSU providing recourse in securitised</p>	<p>Subject to the investment guidelines applicable to the PSU/PSFIs investments can be made in securitised debts wherever exposure of the Central Board of Trustees, Employees' Provident Fund can be treated as exposure towards top rated (e.g. AAA) PSU/PSFIs/other body corporate.</p>

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		debts .	However, portfolio manager may pay more attention to the security aspect while doing appraisal about the proposals related to securitised debts.
7. No investment is permitted in Corporate Sector and in private sector banks	No comments.	<p>As per the existing investment pattern, 10% of fresh accretions (1/3rd of residual category of 30%) can be invested in private sector bonds/securities which have an investment grade rating from at least two credit rating agencies subject to risk return prospects. CBT, EPF did not opt for investment in private sector bonds/debentures earlier. At that time Term Deposits were not permitted in the investment pattern. Private sector banks such as ICICI Bank, HDFC Bank and others may be considered as potential investment avenues. At one point of time, CBT, EPF had invested more than Rs. 3800 crores in erstwhile ICICI, which is merged with ICICI Bank now. ICICI serviced its debt obligations very well. Present investment in ICICI Bank was Rs.1219.02 crores as on 30.09.2003. All commercial banks i.e. Public sector as well as private sector banks are subjected to the same regulatory norms of RBI.</p> <p>Accordingly, investments in Private Sector banks with AAA rating by two credit rating agencies may be permitted subject to ceiling laid down in the investment pattern.</p>	<p>Existing policy of not exercising the option for making investment in corporate sector debentures/bonds may be continued. However, investments in bonds/debentures and term deposits of private sector banks may be made subject to following:</p> <p>(a) Total exposure in any private sector bank should not exceed 10% of its net worth.</p> <p>(b) Issue of Bonds/debentures is approved by RBI/SEBI.</p> <p>(c) Bonds/debentures are AAA/top rated by two credit rating agencies and tenure of the bonds should not exceed 8 years.</p> <p>(d) Net worth of the bank should not be less than 100 crores.</p> <p>(e) Ceiling for investments prescribed in investment pattern in respect of investments in the private sector should be adhered to.</p> <p>(f) Ceiling for investment in a particular Bond/debenture issue will be 5% of total funds to be raised from market under such issue.</p>
8. No investment in State	Good investment opportunities may be encashed	Finance & Investment Committee had earlier decided that no fresh investments be made in the State Government Guaranteed	Earlier decision on this issue may continue. However SBI may restart appraisal of investment opportunities

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<p>Govt. guaranteed securities for the time being.</p>	<p>instead of blanket ban.</p>	<p>Securities for the time being keeping in view precarious financial position of the State Governments. Portfolio manager has even stopped evaluating the investment opportunities under this category.</p>	<p>under the State Government guaranteed category on merits.</p>
<p>9. No guideline at present for giving preference to SDL over relatively low yielding Central Government securities</p>	<p>No comments.</p>	<p>Government of India borrowings and State Development Loans are regulated under Article 292 & 293 (2) of the Constitution of India. Hence, both are having similar security but yield in SDLs are 50-60 basis points higher than Government of India securities. Investment pattern provides liberty to invest 30% of the fresh accretions under the residuary category in any of the three categories namely Central Government, SDLs & Government guaranteed and PSU/PSFI category. For investing Funds pertaining to residuary category SDL deserves preference over relatively low yielding Central Government securities. Interest and maturity proceeds on investments in SDLs are being serviced by RBI as in the case of Central Government Securities.</p> <p><u>Article 292 Borrowing by Government of India</u></p> <p>The executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed.</p>	<p>SBI may give preference to SDLs over Central Government securities for getting better yield while making investments out of residuary category (30%).</p>

			<p>Article 293 (2) Borrowing by States</p> <p>The Government of India may, subject to such conditions as may be laid down by or under any law made by Parliament, make loans to any State or, so long as any limits fixed under article 292 are not exceeded, give guarantees in respect of loans raised by any State, and any sums required for the purpose of making such loans shall be charged on the Consolidated Fund of India.</p>	
10.	Gilt Funds	<p>SBI's views were received vide letter dated 21.10.2003 (Copy enclosed). Annex A-4</p>	<p>Matter was referred to the Government of India to clarify whether the provident funds are allowed to sell government securities and whether the PFs are allowed to exit from the Gilt Funds as and when required. Related accounting issues are to be sorted out by the EPFO as per condition No.24 of revised conditions for grant of exemption.</p> <ul style="list-style-type: none"> <i>Inflation rate in the economy has shot up to 6% (approx.) and yield in case of ten year government security was 5.15% on 27.1.2004. Accordingly, real rate of return is negative and in case of any upward movement in the interest rates there are abundant chances of loss of principal also.</i> 	<ul style="list-style-type: none"> Till Government of India gives permission to exit from Gilt Funds no investment be made in the Gilt Funds. After grant of exit option by the government the same can be utilized in prudential way under the circumstances suggested by SBI in its letter dated 21.10.2003 and subject to following ceilings: <ol style="list-style-type: none"> Ceiling for investment in a particular Gilt Fund will be 5% of total funds raised (corpus of the gilt fund)/to be raised from market in case of new issue. At present Investment is to be made only in the gilt funds established in the public sector. To begin with investments be made only in growth funds. Matter may be taken up with SBI for arriving at the scale of charges regarding investment in Gilt Funds after getting permission to exit from the Government.

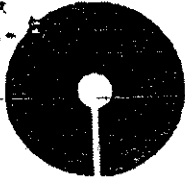
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			<p>(e) Portfolio manager may form a view on interest rates scenarios at first instance and inform investment committee of CBT and then only start making investments in gilt funds that too only if they feel that there are no chances to lose the principal itself.</p>
<p>11. Scouting for investments in ever-growing Public Sector having good track record e.g. FCI, NTPC, NHPC and NHAI etc.</p>	<p>No comments</p>	<p>Keeping in view the huge demand of funds in the stated entities, if certain funds are placed directly with them, it may facilitate to increase the yield by obviating the intermediaries.</p>	<ul style="list-style-type: none"> • SBI may Scout for direct investments in ever-growing Public Sector having good track record e.g. FCI, NTPC, NHPC and NHAI etc. • CPFC may also facilitate Portfolio manager's efforts by making a reference to CEOs of the gaint public sector bodies . • Investments are subject to prudential exposure limits laid down by Central Board of Trustees, Employees' Provident Fund.
<p>12. Idle funds</p>	<p>Had Repo and CBLO been permitted, idling of funds could have been prevented. Approval is required from Central Board of Trustees,</p>	<p>Quantum of investible funds vary depending upon cash inflows on account of fresh accretions, interest and maturity proceeds etc. In case of huge cash inflows, at times it is not possible to deploy the funds on the day of receipt due to non-availability of suitable investment avenues. In these cases funds can be parked temporarily in Treasury Bills/TDR. Often Treasury Bills are not available for desired quantity and</p>	<ul style="list-style-type: none"> • Investment be made in the Central Government Securities in the Repo market and requisite permission be obtained from RBI to avoid idling of funds.

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	<p>Employees' Provident Fund, RBI, Ministry of Finance and Ministry of Labour. SBI's fax dated 28.01.2004 (Copy enclosed as Annexure A-1).</p>	<p>amount. Further, TDRs are not available for less than 7 days period. Due to these constraints losses on account of idling of funds may be to the tune of crores of rupees. For instance SDS interest amounting Rs.4407.78 crores was received on 01.01.2004 and funds could be deployed up to 21.01.2004 only. Due to aforesaid constraints average Idle Funds in Provident Fund Account alone shot up to 855.51 crores during the period 01.01.2004 to 15.01.2004. This happened in spite of relaxations in the exposure norms for TDRs and for making investments in SBI (letter dated 24.12.2003 enclosed). SBI has also given special report dated 24.01.2004 for ratification by Investment Committee (Copy enclosed as Annexure A-2).</p> <p>Repo is a transaction in the Central Government Securities and hence permissible under the Investment Pattern.</p> <p>RBI has permitted LIC and other insurance companies to lend in the Repo market and it facilitates them to avoid idling of funds.</p>	
		<p>A brief regarding Repo is enclosed (Annexure A-3).</p>	



भारतीय स्टेट बैंक
State Bank of India

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ताए/Telegram : APEX

June 69 (R)

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Shri Ajai Singh, IAS
Central Provident Funds Commissioner
Employees Provident Fund Organisation
Bhavishya Nidhi Bhawan
14, Bhikaiji Cama Place
New Delhi 110 066

ANNEXURE A-4

24 June - 3

S.O. 1 no (1)
20. put up in
Inv. section file
23/10

क्र. क्रमांक / No

दिनांक / Date

PMSCS/TR/1389

October 21, 2003

Dear Sir,

Investments in Mutual Fund Gilt Schemes

We refer to your request for furnishing our views on the proposed norms for investment in Gilt Funds as presently permitted under MOF/MOL notifications.

2. Furnishing advice/views on such matters is not covered under the present PMS agreement between EPFO and SBI but in view of our longstanding ties, we offer the same as a gesture of goodwill. As the history of Gilt funds is very recent and the Bank itself has not availed of this opportunity, our experience/expertise has been drawn on to a very limited extent. We have placed a greater reliance on the presentations/interaction with the leading Fund Houses, including our own associate SBI Mutual Fund, to evolve some tentative guidelines/benchmarks.

3. Before we spell out the proposed norms, it would be necessary to highlight certain basic departures from the extant EPFO norms, in investing in Gilt Funds. These are as under:-

- i. Present investment norms do not allow for exit options/disinvestments, except under very restrictive circumstances, that too without capital loss.
- ii. Present investments are made where the return/yield is determined ab initio, i.e. at the time of investments. Likewise, the maturity of the investment is known/decided at the time of the investment. As a result, at the time of making the investment in Gilt Funds, neither would be pre-determined, as at present.
- iii. For non-Govt. security investments, rating by a recognized agency (CRISIL, ICRA etc) is a pre-requisite, and investment is made only in the top most rated paper. With Gilt funds, a rating process is not available.
- iv. Tracking of the performance is not a part of the investment management, as only credit risk is presently recognized. With mutual funds, there is a strong element of market risk i.e. day-to-day fluctuations in market determined rates and sale value of investments, leading to appreciation/depreciation of the invested corpus.

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23/10/03
APRC No. 24881
24/10/03

- v. Mutual Funds would be churning their portfolios i.e. sale and purchase of securities, as trading profits constitute an important part of their fund profits. Since this is not permissible in the case of direct investments made as per extant norms, investing in mutual funds constitutes, in a sense, an indirect violation of the restriction on sale. Also, trading can lead to losses and asset erosion, particularly during an upward movement interest rates. There is heavy reliance on the correctness or otherwise of the view taken by the fund administrator.
3. The above are features that are inherent in the very concept of Mutual Funds and are not specific to Gilt Funds or any Fund House in particular. Since a decision has been already taken to permit investments in Mutual Funds, it can only be presumed that this has been done in full awareness of such basic departures in the norms. We are making these points explicit as the proposed norms need to address these aspects.
4. In this connection, one critically important aspect that requires emphasis is the fact that Gilt Funds would do well in a declining interest rate scenario, as has been the case over the past two/three years where Govt. Securities yields have fallen by 600 basis points. Further decline in yields to this extent may not be sustainable over a protracted period, and in a rising (or even stable) interest rate scenario, the profitability of Gilt Funds is likely to be substantially diminished. The prospects of capital loss stand enhanced considerably as the asset values, after investment, may decline in case interest rates register an upward movement.
5. Against the backdrop of what has been stated above, we have evolved the following tentative norms. These would need to be reviewed not later than one year in the light of the experience during this period. We, therefore, suggest the following :-
- (i) Size of investment
We may restrict the investment to Rs. 500 crs for the financial year.
 - (ii) Selection of Funds
 - (a) Gilt funds with minimum corpus of Rs. 200 crs
 - (b) For the present, exposure to only to Fund Houses in the Public Sector.
 - (c) Restrict exposure to 25% of the existing corpus.
 - (iii) Performance Criteria
At present, the only criteria available in the public domain is the CRISIL CPR

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(iv) Type of Gilt Funds

There are two types of funds viz. Growth Funds and Income Funds. To begin with, we would confine our subscription to only growth funds which are long term in nature and are less susceptible to market volatility/capital loss.

(v) Exit Option

This is a critical aspect as it involves a high level of subjectivity. Both exercising or not exercising the option can lead to opportunity loss, depending on the circumstances. We suggest that exit from any scheme be exercised under the following circumstances :

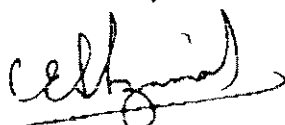
- a. Appreciation in net asset value to the extent of 15%. The appreciated amount could be encashed and reinvested as additional units in either some other or the same fund or directly in G-Secs.
- b. Depreciation in net asset value by 10% over a period of three months (one quarter). The disinvested amount may be deployed directly in other assets or in other Gilt Funds
- c. Reduction in ranking below CPR-3 or a two notch downgradation in rank for two quarters.
- d. Pro-rata exit in case our investment exceeds 25% of the corpus net of our exposure. (Such over-exposure can happen in case other investors withdraw after we have invested).
- e. Any unsatisfactory features or market reports or definite prospect of take over of the Fund by other entities/corporates.

6. In conclusion, we would like to re-emphasise that this form of investment entails a new and significant area of risk, viz. market risk. A more detailed explanation and analysis thereof can be made separately, by means of discussions/presentation rather than by correspondence. We would also like to spell out the fact that the review and follow-up of such investments is a much more rigorous matter, involving quality-time at various levels, and we may not be able to render this service under the present scale of charges. We propose to dilate on this aspect separately.

7. We trust we have been able to furnish the required feedback to enable you to commence the exercise of devising the appropriate norms. We would be happy to furnish any further views/clarifications required to complete this exercise.

8. We will undertake the new type of investment after the guidelines are duly approved by the Trustees.

Yours faithfully,



(C. E. S. Azariah)
Chief General Manager (Treasury)

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ANNEXURE A-I

Page - 3

From:	rsbsat_123@yahoo.co.in
To:	facao@vsnl.com
Subject:	sds interest investment
Date:	Wednesday, January 28, 2004 4:32 am
Attachments:	The Financial Advisor and Chief Accounts Officer.doc(23K), excessexposure.doc(21K)

Dear Sir,

Enclosed please find two files containing the letter and statement where the expos 25% has been exceeded.

BRS satyanarayana
Chief Manager (PMS & CS),
SBI, Coproprate Centre,
Mumbai 400 021

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The Financial Advisor and Chief Accounts Officer,
Employees Provident Fund Organisation,
Bhavishya Nidhi Bhavan,
14, Bhikaiji Cama Place,
New Delhi 110 066

ATTN SHRI ANIRUDH RAI

Dear Sir,

**DEPLOYMENT OF SDS INTEREST
CHANGES IN INVESTMENT NORMS**

With reference to your letter no. Investment-I/1(18)96/Pattern/Vol.VI/73154 dated 24/26-12-2003, we advise that SDS interest amounting to Rs.4407.78 crs was received on January 1st, 2004. The total amount disbursed by RBI was reportedly to the tune of Rs. 8000 Crores, including Rs. 4407.78 Crs.above, and market absorption was rendered extremely difficult.

02.However, we could complete the deployment (as per Finance Minsitry distribution pattern) by January 21st, 2004. The amounts invested were as under

CGS -- Rs. 1250 Crores in the primary issue (auction) in the scrip on 5.87% G Sec 2022 opened on 07-01-2004 and closed on the same day.
SDL -- Rs. 2075 Crores in the Primay issue opened on 19-01-2004 closed on 21-01-2004 at yield of 5.90% (5.90% SDLs 2017)
PSU -- TDRs. -- Rs. 1082.78 Crores for periods ranging from for 150 days to 364 days,at rates ranging from 5.55% to 5.75%

As on 27th January 2004, the investments pattern is as under :

Category	Actual investment	% of total
CGS	4000.72	29.67
PSU	5960.06	44.19
SDL	3526.01	26.14

03. We have not made any secondary market investments in view of the low yields. However, due to the time lag between receipt of funds and dates of primary issue, there has been a degree of idling of funds. We could park

Rs. 2000 Crs for 14 days @ 4.60% towards the state government paper issue on 19th January, but for the CGS security, this was not possible as the time lag was less than the minimum 7 days stipulated by banks.

04. In this connection, had EPFO been permitted to avail of RBI's repo facility and/or CBLO money market instrument such idling could have been prevented. We suggest that the legal aspects be got examined, as Trust funds are involved and the CBOT/Ministry of Labour/Ministry of Finance be approached to seek approval from RBI for availing of such facilities.

05. Regarding term deposit investments, these are not just temporary parking but are investments fetching a yield in excess of what is available in the secondary market. Bank bonds are, of course, available at rates between 5.50% to 5.90% but these are for extended maturities (beyond seven years) and it was felt imprudent to lock into such low yields for extended periods. In this connection, we have enclosed a list of banks where we have breached the limit of 25% of networth vide our letter no. Tr/PMS/2119 dated 21-01-2004. We enclose our updated list and request that Investment Committee ratification be sought.

Yours sincerely,

Deputy General Manager
(PMS & CS)

**INVESTMENTS MADE ON BEHALF OF WHERE THE EXPOSURE LIMIT OF 25%
HAD EXCEEDED AS ON 28-01-2004**

Organisation	Networth	25% of Net worth	Present exposure	Excess by
(1)	(2)	(3)	(4)	(5)= (4)-(3)
Bank of Maharashtra	980.27	245.07	985.00	640.07
Union Bank of India	2072.09	518.02	721.50	203.48
State Bank of Saurashtra	625.44	156.36	390.00	133.64
Andhra Bank	1115.43	278.86	360.00	81.14
State Bank of Hyderabad	1250.94	312.73	447.00	134.27
Syndicate Bank	1579.79	394.89	437.00	42.11



भारतीय स्टेट बैंक
State Bank of India

कोष विभाग, कारपोरेट केन्द्र, पत्र पेटी क्र. 12,
मुंबई-400 021.
Treasury Department, Corporate Centre,
Post Box No. 12, Mumbai-400 021.
फैक्स/Fax : 2204 5468 / 2202 8779 / 2286 8220
तार/Telegram : APEX

THE REGIONAL PROVIDENT FUND COMMISSIONER (INVT)
EMPLOYEES PROVIDENT FUND ORGANISATION
BHAVISHYA NIDHI BHAVAN, 14, BHIKAJI CAMA PLACE,
NEW DELHI - 110066

आ. क्रमांक / No.

दिनांक / Date :

Tt/ PMS/

24.01.2004

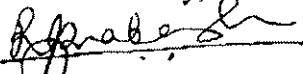
Dear Sir,

IDLE FUNDS STATEMENTS FOR THE PERIOD :
(1) 01.01.2004 TO 15.01.2004

We forward herewith the abovementioned statement for your kind information.

2. We had received on 01/01/04 SDS interest of Rs. 4407.79 crore. In order to present a clearer picture of the actual level of idle funds, we have prepared two statements of idle funds for the fortnight under review, one pertaining to SDS interest received and invested and the other pertaining to the usual funds received and invested. An auction of Central Government Securities was held on 07/01/04 and payment was due and made on 08/01/04. The auction of State Development Loans was held on 19/01/2004 and payout date was 21/01/04. We completed deployment of the idle funds on 21/01/04 and this will be reflected in the idle funds statement for the fortnight 16/01/04 to 31/01/04. The idle funds for the SDS interest received and invested were Rs. 855.51 crore and that for funds received and invested in the normal course Rs. 22.97 crore.

Yours faithfully,


for Deputy General Manager
(PMS & CS)

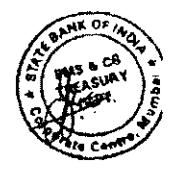
Annex-2/2
Item 3

EPF ACCOUNT NO. 5
DETAILS OF SDS INTEREST RECEIVED AND INVESTMENTS MADE
IDLE FUNDS STATEMENT FOR THE PERIOD 01.01.04 TO 15.01.04

DATE	OPENING BALANCE (RS. CR.)	INVESTMENTS MADE	YTM %	AMOUNT (RS. CR.)	VALUE DATE	CLOSING BALANCE (RS. CR.)
01/01/04	Nil					4282.89
02/01/04	4282.69	5.70% qly cmp FD SBH for 364 days mat 31/12/04	5.8	100	02/01/04	
		5.60% qly cmp FD BOM for 8 mths mat. 02/07/04	5.62	200	02/01/04	
		5.60% qly cmp FD BOM for 6 mths mat. 02/07/04	5.62	300	02/01/04	
		4.25% SB India FD for 10 days mat. 12/01/04	4.25	2000	02/01/04	
		5.75% Andhra Bk.FD for 9 mths 2 days mat. 04/10/04	5.75	200	02/01/04	
		total		2800		1482.74
03/01/04	1513.83	5.55% SBS FD for 150 days mat. At 01/06/04	5.57	100	03/01/04	
		5.60% SBS FD for 8 mths mat.03/07/04	5.62	100	03/01/04	
		total		200		1313.83
04/01/04	1313.83	Sunday				1313.83
05/01/04	1313.83	No transactions				1313.83
06/01/04	1325.41	5.60% FD of BOM for 9 mths mat. 06/01/04	5.68	100	06/01/04	
		5.60% FD of UBI for 364 days mat. 04/01/04	5.7	100	06/01/04	
		total		200		1125.41
07/01/04	1132.97	Tr. To Mumbai Main Br (Req No. 36)		20	07/01/04	1112.97
08/01/04	1113.83	5.87% GS 2022(Bid Rs 250.00 Cr.)	5.85	255.82	08/01/04	
		5.87% GS 2022(Bid Rs 500.00 Cr.)	5.82	513.35	08/01/04	
		5.87% GS 2022(Bid Rs. 354.86 cr.)	5.8	365.15	08/01/04	
		total		1134.32		-20.49
09/01/04	0.04	No transactions				0.04
10/01/04	8.6	Tr. To Mumbai Main Br (Req No. 36)		18.6	10/01/04	-10
11/01/04	0.06	Sunday				0.06
12/01/04	0.06	4.25% FD with SBI for 7 days mat. 19/01/04	4.25	2000	12/01/04	
		5.65% FD with UBI for 364 days mat. 10/01/05	6.75	2	12/01/04	
		total		2002		-2001.94
13/01/04	3	5.65% FD with UBI for 364 days mat. 11/01/05	5.75	3	13/01/04 nil	
14/01/04	0.21	No transaction				0.21
15/01/04	0.34	Tr To Mumbai br. (Req.No.37)		1.8	15/01/04	Nil

Average Idle Funds for the period 01/01/04 to 15/01/04 =Rs 796.37 crore

Average idle funds for the period: $Rs (796.37 + 59.14 + Nil)$
= Rs. 855.51 crore



S.L.No. 77 (Issue)

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EMPLOYEES' PROVIDENT FUND ORG.
(Ministry of Labour, Govt. of India)
Head Office

Bhavishya Nidhi Bhawan, 14, Bhikaiji Cama Place,
New Delhi - 110 066

IN
Annex A-3/2
Ann 3

Telefax

No. Investment-I/1(18)96/Pattern/Vol. VI/

73157

Dated: 24.12.2003

To

26 DEC 2003

Shri T. Ajraya

Chief General Manager (Treasury)
Treasury Department, Corporate Centre,
Post Box No. 12,
Mumbai - 400 021.

Subject: Investment Guidelines - Suggested Changes regarding investment in unlisted bonds and reinvestment of interest on SDS

Reference: Your letter No. PMSCS/TR/1866 dated 17.12.2003 and PMSCS/TR/ 1844 dated 12.12.2003

Sir,

Regarding unlisted bonds it may be recalled that under the existing investment pattern/ guidelines, there is no bar on purchase of unlisted securities. Further there is no liquidity problem to be faced in the short terms / in near future. Accordingly, under the existing investment pattern & guidelines, SBI may go ahead to purchase the securities (Bonds/Debentures) even though unlisted so as to get higher than normal yield. However, SBI may make investments in financially sound PSUs / PSFIs / Banks only as per existing guidelines.

2 Regarding reinvestment of interest on SDS, SBI may make a trade off between idle funds and availing of investment opportunities at appropriate time & rate. Best efforts be made to park the funds temporarily in Treasury Bills / TDRs to avoid idle funds. Funds may not be invested in the market just to fall victim in the hands of market manipulators. Rash investments causing lower yields in totality are not advisable. For short term parking of funds, even if SBI needs to make investments in excess of 25% of the net worth, the same may be made as an exception to meet the exigency to avoid losses to Central Board of Trustees, Employees' Provident Fund but a specific report of all such cases be given for placing before the investment committee of EPFO in its next meeting.

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3 SBI may take up the matter with RBI to seek opportunities regarding SDLs fetching higher yield (than Central Govt. Securities) and release of funds in phased manner. Government of India is being requested to advise RBI to either credit the interest in SDS A/C or to release the interest to EPFO in a phased manner i.e. monthly to avoid undue manipulation of prices by the market forces. Since it may be a long drawn process, all possible measures will have to be taken to avoid loss to Central Board of Trustees, Employees' Provident Fund.

Yours faithfully,


(ANIRUDH RAI)

FINANCIAL ADVISOR & CHIEF ACCOUNTS OFFICER

जारी किया
ISSUED

BRIEF ON REPOS

Repos in Indian Market – Nature of transaction

Repo (Repurchase Agreement) or Ready Forward transaction in the Indian money market involves sale of specific securities by one party (the seller) to the other party (the buyer) at a mutually agreed price and also, as a part of the same transaction, buy-back of the same at the end of a specified period at a mutually agreed price. Effectively the seller of the security borrows money for a period of time (Repo Period) at a particular rate of interest mutually agreed with the buyer of the security who has lent the funds to the seller. The rate of interest agreed upon is called the Repo Rate. The same transaction from the buyer's (lender's) point of view is called **Reverse Repo**.

Repo A Repo transaction has thus two legs; the spot/cash leg (I leg) and the forward leg (II leg) when the security is repurchased by the original seller. Repos are borrowing/lending transactions in essence but take the legal form of purchase/sale of securities. Repo may, therefore, be looked upon as a hybrid instrument. In practice Repos are flexible money market instruments, which facilitate adjustment of inter-bank liquidity in a collateralised manner.

Legal Position

As per Government of India Notification No. S.O. 2561 dated June 27, 1969 issued under Section 16 of the Securities Contracts (Regulation) Act, 1956 all forward contracts in securities had been banned excepting ready forward contracts specifically exempted by the Government. Government of India has since rescinded the 1969 Notification and delegated powers to Reserve Bank of India under Section 16 of the Securities Contracts (Regulation) Act, 1956 for regulating contracts in government securities, money market securities, gold related securities and derivatives based on these securities, as also ready forward contracts in all debt securities. Reserve Bank of India has vide its notification dated March 1, 2000 (published in the Gazette of India: Extraordinary vide S.O., 185(E)) has permitted Repos and Reverse Repos subject to the terms and conditions and among the participants as specified hereunder:

- (a) **ready forward contracts are undertaken only in Treasury Bills and dated securities of all maturities issued by the Government of India and State Government,**

- (b) ready forward contracts in the securities specified at (a) above may be entered into by a banking company, a cooperative bank or any person maintaining a **Subsidiary Ledger Account** and a **Current Account** with Reserve Bank of India, Mumbai , only among themselves.
- (c) Such ready forward contracts shall be settled through the **Subsidiary General Ledger Accounts** of the participants with Reserve Bank of India at Mumbai only, and
- (d) No sale transaction should be put through without holding the securities in the portfolio.

Repo Period

Repos can be undertaken for any period of time. An earlier restriction of minimum period of three days has been withdrawn. RBI has clarified that there is no maximum period for repos.

Risk in Repos

Although Repo is a collateralised mode of lending it is not entirely risk-free. Market risk, issuer risk and counterparty risk should be taken due care of while undertaking Repos. In fact, even the borrower faces a risk in the sense that the lender may default in selling back the security. In developed markets, these risks are addressed and mitigated by putting in place proper systems, the system of Tripartite Repos being one. However, Indian Repo market is not so developed in terms of self-regulation and settlement infrastructure. The safeguards practised in developed markets such as imposition of initial margins, recovery or margins based on marking to market to protect the initial margin, use of Master Agreements etc. are not in vogue in the Indian Repo market. It is, therefore, necessary that proper counterparty limits are put in place and self-imposed restrictions regarding the maximum period, rollovers etc. are observed.

Advantages of undertaking Repos

Let us now understand the reasons for undertaking Repo. For this, it is necessary to note that when a security is sold outright (without any commitment to repurchase), the seller faces a price risk and he may have to book losses. Cash can be generated by undertaking Repo in the security without the attended price risk. ***From the lender's point of view Repo helps collateralised investment of surplus cash achieving money market returns with sovereign risk.***