Pressure increases to fund employee gratuity

The current downturn is making regional companies rethink their employee benefit strategies. **Ritwika Chaudhuri** finds out that companies are much keener today to look at funding their gratuity obligations towards employees.

These days, discussions during weekend dinner gatherings mainly revolve around uncertainty, job losses, and people being forced to relocate without an alternative employment opportunity.

Though layoffs are usually packaged with perhaps a few months of advanced salary, end of service benefits, gratuity payments etc., imagine a situation where employers have no money to even pay the dues! And it's impossible to rule out this possibility in the present circumstances.

Traditionally, companies operating in the region have been cash rich, and they managed their liabilities, especially end of service benefits drawing from their working capital or from revenue earnings. However, with the current downturn being quite sharp and severe, companies are witnessing a slowdown in revenue earnings, squeezed margins and reduced cash flows. Add to that tremendous pressure to reduce costs, and one of the heads to get the chop has been manpower.

"If a company has a corporate group saving plan that can take care of its gratuity provision, employers will have the peace of mind while cutting back on human capital, and at the same time employees can be confident of the availability of legal end of service dues in the absence of regular income," points out Philip Story, head of employee benefit, Friend's Provident International (FPI).

Michael Brough, senior international consultant, Watson Wyatt Worldwide, adds that at some point of time, for big companies gratuity will become a problem as very few companies are funding liability in the region.

"Liability is building up in this region, and hence, governments need to introduce some forced funding norms. As of now no regulations or legislations are being implemented with regard to gratuity funding," says Brough.

Story, however, thinks that a number of companies are gradually realising the importance of segregating assets from

liabilities. While for the newer and smaller companies liabilities are not huge and hence manageable, for big companies, liabilities are larger and, hence, it is important for them to segregate the book, and to make sure that money due to employees is always there, he suggests.

Callum Burns-Green, principle at Mercer, agrees, and adds: "Though there is no tidal change in the gratuity funding area as of now, we can see there is growing interest in this area. Companies are taking actuarial help to appropriately account the end of service amount, and trying to identify the nature of these liabilities, and hence, making sure that they have the necessary provision for that."

Current market trends

James Thomas, associate director at Acuma Wealth Management, estimates that 80 per cent of the regional companies are still making gratuity payments from their regular cash flows. He says that in the current situation which is forcing significant redundancies, all at the same time, senior management in many companies are being forced to sit up and think.

"The issue of gratuity funding is very clearly highlighted, more so when many companies do not have adequate money," he adds.

Graham Morrall, regional head of distribution, Zurich International Life Limited, has similar views. He says that even until a few months back employers were not faced with a situation when they had to let go of a significant number of their employees, all at the same time. In the past, they were very comfortable funding their gratuities from cash flow, as they had been cash rich. Now, as cash is becoming scarce, large outlay has become an issue, he adds.

There are other reasons too for gratuity funding not being a popular practice in the region. Robin Ali, head of sales and marketing, medical and financial services-Lifecare International, points out that returns from core business for most companies in the region have been as high as 20-25 per cent. So, it is to be expected that these companies preferred that their money remained invested in their core business, while they funded the end of service benefits from revenues and earnings.

Lack of awareness is also one of the primary reasons, according to Morrall. In the past, there were not many schemes around, and there was a lack of advisory expertise as well, while unavailability of third party products too was an issue, he adds.

There is a discernible change now in that

Graham Morrall

trend, and while specialised consultancy firms like Mercer, Watson Wyatt and insurance companies are succoring the market for new business, clients like the Al Hathboor Group, which introduced a gratuity funding scheme for their employees, is increasingly the new face of best practices.

In fact, according to Story, FPI is meeting four new companies every week on an average to advice on this issue.

"As long as companies can see the benefit of such schemes, even if there are additional costs, they are eager to go for such packages which will serve dual purpose of retaining people as well as meeting corporate obligations," Story points out.

Today, employers have the choice of investing in investment schemes that

Box 1

Existing gratuity rules in UAE

A gratuity is a lump sum set aside to be paid as end of service benefits when an employee retires or leaves a company. Historically, companies in the UAE have provided gratuity schemes for employees rather than traditional pension schemes.

While most companies, and even free zones like Dubai Airport Free Zone or Jebel Ali Free Zone come under the UAE Labour Law, the Dubai International Financial Centre (DIFC) has its own labour law.

The UAE Labour Law and the DIFC Law both contain gratuity provisions, whereby, employees are entitled to a lump sum payment benefit upon termination of their employment, calculated on the number of years of service with an employer, subject to the completion of at least one year of service. The basis of the calculation for both laws is 21 days' basic salary for the first five years of service and 30 days' basic salary for any period of service over the five years of service.

However, the laws differ slightly with respect to the reductions in the gratuity payment where an employee resigns from his or her position. The UAE Labour Law states that in such event, an employee's gratuity is reduced by two-thirds where their period of service is between one and three years and by one-third where their period of service is between three and five years. For any period of service over five years there is no reduction in the gratuity entitlement. The DIFC Law has no such corresponding provisions, and therefore, an employee is entitled to their full gratuity entitlement irrespective of whether they resign or are terminated.

James Thomas

Box 2

Employee benefits given by MNCs and select regional companies in the UAE

- 81 per cent provides death benefit through insurance and often with riders covering accident and disability benefit.
- 41 per cent provide long term disability benefit
- 85 per cent MNCs provide private medical insurance policy
- 41 per cent provide short term sickness benefit
- 59 per cent provide permanent and total disability
- 85 per cent provides defined benefit-style end of service plan
- 8 per cent provides supplementary pension plan in addition to end of service plan
- 10 per cent provide funded end of service benefit outside the company
- 59 per cent provide company car benefit
- 63 per cent provides travel insurance

Source:
Mercer Middle East Survey - UAE (2007-2008), survey sample= 27 companies

Philip Story

allow putting aside both lump sums and regular amounts of money to fund their gratuity liabilities. Generally, these monies are invested in low risk funds or assets returning may be four to five per cent per annum.

Companies can also start their own funds and use a combination of cash, bond and equity to ensure low risk. At a later stage, even the employees can be involved by allowing them to pay.

"Since gratuity payment depends on final basic pay, companies need to be aware of what to set aside, and based on that decide whether to allow employees to add their own money," explains Morrall.

The other option is to take advice from the firms having expertise in employees' benefit schemes and invest capital in different structured insurance schemes and international funds managed by investment houses or consultants.

International insurance companies such as FPI and Zurich International Life offer flexible plans for gratuity funding. FPI has recently launched a group savings scheme called Optus which is designed to allow companies to make provisions for employees' gratuity liability with the option of providing additional occupational benefits for employees.

Schemes like Optus and many of these plans are also flexible enough to be used for employee savings schemes and retirement provision. Importantly, they can be written in trust so that, in the event of a business collapsing, the funds are protected from creditors.

A packaged deal

While talking about end of service dues, it's hard to differentiate between gratuity funding and pension schemes since, in most of the developed economics, for big companies, they are interlinked and driven by a company's perspective, brand image and requirement. Besides, specialists point out that it is always a good idea to build the gratuity funding element around a long-term saving/pension scheme, as that is done with less additional cost.

Burns-Green says that "provision of benefit" is still a developing area in this region. He says that though retirement saving is becoming a subject of increasing

Callum Burns-Green

interest in countries like UAE, Qatar and Saudi Arabia where introduction of state benefit schemes or compulsory provision of retirement benefit schemes are under consideration, there is no hard legislation so far in this area.

A survey conducted by Mercer around end of 2007 gives an insight into this aspect (See Box 2). Interestingly, it finds that, while the majority of multinationals provide minimum benefits to employees and try to match the package they offer in their home countries, few large local companies have similar funding arrangements so far end of service savings scheme is concerned. The survey also highlights that life endowment, disability and medical benefits are common with private companies, but now a number of companies are showing interest in providing supplementary retirement savings plan in order to provide a stable expatriate working environment and sustaining them longer term in this region.

The Gulf region is no longer being considered just as a stopover for few years to earn tax free incomes, but more people are considering staying here longer, some even planning their retirement.

Unlike earlier days when typical employers expected turnover of staff every two to three years and handful of employees leaving at a particular time, now, as people plan to stay longer, it is high time that companies start adapting to the new realities. It is vital that they introduce pension linked savings schemes and also ensure larger sums to take care of end of service benefit and gratuity payment to attract and retain talent and loyalty.