

# **Investment Policy Statement**

## **Employees' Provident Fund**

### **1. Preamble**

As per the Employees' Provident Fund (EPF) Act, No.15 of 1958, as amended, a retirement benefit scheme was set up to cover the mandatory defined contributions made by the private sector and semi-government sector employees. As per the EPF Act, the Commissioner of Labour is vested with the powers to administer the Employees' Provident Fund, while the Monetary Board (MB) of the Central Bank of Sri Lanka (CBSL) is responsible for managing the Fund. The EPF Department is established within the CBSL and entrusted with activities related to the collection of member contributions, managing the fund and repaying members, as and when benefits are claimed. This document sets out the summary of the Investment Policy Statement (IPS) of EPF.

### **2. Governing Authority**

The powers and duties of the MB in relation to the Fund have been laid down in Section 5 of the EPF Act.

### **3. Objective of the EPF**

The objective of the EPF is to provide a retirement benefit scheme that covers the mandatory defined contributions made by its members, who are guaranteed a minimum annual interest rate of 2.5 per cent on member balances by the EPF Act.

### **4. Scope of the Investment Policy Statement**

The IPS sets out the strategic framework that guides the activities of the EPF Investment Oversight Committee (EIOC), EPF Investment Committee (EIC) and the EPF Department in their respective roles in the fund management process. In addition, the IPS provides the risk management framework relating to the EPF fund management activities. The IPS also specifies the investment objectives of the Fund, the eligible asset classes and the aggregate risk tolerance levels of the CBSL for the management of the Fund.

## **5. Liquidity Policy**

The EPF Department is required to ensure that adequate liquidity is maintained to fulfill the day-to-day liquidity requirements such as refund of member benefits and to meet the capital and operational expenses. Accordingly, appropriate amount must be allocated from the fund for daily liquidity requirements and must be considered during the planning of its investment horizons.

## **6. Risk Tolerance**

The risk exposures should be based on the objective of maximizing expected returns. EPF will target an annualized nominal return, over and above annual average inflation measured by the Colombo Consumer Price Index (CCPI) over the 10-year horizon of the Fund, while safeguarding the members' contribution, and ensuring the prompt payment of refund benefits.

## **7. Tax Consideration**

The Fund is subject to an income tax on its taxable income in terms of the Inland Revenue Act. Hence, investment decisions shall be evaluated on after tax basis.

## **8. Investment Objectives**

The IPS sets out the framework for the effective and efficient realization of the investment objectives. To formulate the investment objectives, risk tolerance, liquidity and tax policy are taken into consideration.

The EPF should target a positive real return from its investments. Thus, the EPF investment objectives should seek to maximise the returns commensurate with the risk, which could be borne by the Fund, considering the requirements for capital preservation and ensuring adequate liquidity to meet the benefits payable to the members, etc.

Accordingly, the investment objectives of the EPF are as follows.

**8.1. Providing a Long-Term Positive Real Return**

**8.2. Ensuring the Safety of Member Contributions**

**8.3. Maintaining Liquidity**

## **9. Risk Governance and Risk Management Framework**

### **9.1. The Monetary Board**

Being the highest level of decision-making authority, the MB provides the policy directions and overall risk parameters for the fund management of the EPF and the performance of the fund management activities are reported to the MB by the EPF Department, periodically.

### **9.2. Board Risk Oversight Committee (BROC)**

CBSL's overall Risk Management/Compliance Framework is overseen by the BROC. Accordingly, it is responsible for reviewing and recommending the IPS, Strategic Asset Allocation (SAA) and Investment Guidelines (IG) to the MB considering proposals of the Risk Management Department (RMD) in consultation with EIOC and EPF Department. Further, it ensures that any external developments associated with the risk management/compliance which may have an impact to the EPF fund management activities, are considered in the risk management framework.

### **9.3. Non-Financial Risk Management Committee (NFRMC)**

The main objective of the NFRMC is to maintain oversight to ensure that non-financial risks and matters relating to compliance of the CBSL are identified and analysed in line with the Risk Management Policy Statement (RMPS) and Compliance Manual, and managed within the risk appetite/tolerance set out by the MB.

### **9.4. EPF Investment Oversight Committee (EIOC)**

The role of EIOC is to take broader level investment decisions within the MB approved SAA and IPS, while overseeing the investment activities carried out according to the IG by the EPF Department.

### **9.5. EPF Department**

In pursuing the day-to-day operations pertaining to the fund management activities of the EPF Department, it would maintain Front Office (FO) and Back Office (BO) which are physically and functionally independent from each other. In addition, the EPF Department shall maintain a Middle Office (MO). The FO is responsible for managing investments while the MO is responsible for the risk management and monitoring of fund management activities as the first line of defence. The BO shall carry out the settlement activities related to EPF investments.

## **9.6. EPF Investment Committee (EIC)**

The EIC is responsible for decision making processes pertaining to the day-to-day investment activities of the Fund, based on the strategic directions given by the MB and the EIOC and the conditions stipulated in the IPS, SAA and IG.

## **9.7. Risk Management Department (RMD)**

RMD as the second line of defence is responsible for identifying, analysing, evaluating, treating, monitoring, reviewing and reporting market and credit risks independently, on a continuous basis. It proposes changes to IPS, SAA and IG to BROCC, considering inputs of the EPF Department and EIOC, for the approval of the MB. Further, it reports critical risks to the appropriate authorities and recommends risk management measures to the EPF Department.

## **9.8. Internal Audit Department (IAD)**

The IAD periodically reviews the adequacy of policies, procedures, internal controls, roles and responsibilities of EPF Department to ensure compliance with the IPS, SAA and IG, and reports directly to the Monetary Board Advisory Audit Committee.

## **10. Eligible Asset Classes and Strategic Asset Allocation**

The EPF Department is authorized to invest in the following financial instruments:

- A. Capital Market Instruments
  - i. Treasury Bonds (issued by Government of Sri Lanka)
  - ii. Corporate Debentures and Trust Certificates
  - iii. Equities
- B. Money Market Instruments
  - i. Fixed Deposits
  - ii. Treasury bills (issued by Government of Sri Lanka)
  - iii. Commercial Papers
  - iv. Reverse Repurchase Agreements
  - v. Standing Deposit Facility (SDF)
  - vi. Cash

## **11. Benchmark**

RMD shall specify the benchmarks for the purpose of performance measurement of EPF fund management activities and such benchmarks may change periodically as appropriate.

## **12. Performance Measurement**

The performance of the EPF fund management activities is measured in line with the specified benchmark and reported periodically to the Monetary Board.

## **13. Authorisation**

EPF shall adhere to the specified authorisation procedures in carrying out the fund management activities.

## **14. Restrictions**

The EPF Department is not permitted to invest in or trade in any asset class which is not authorised by this IPS. The authority granted by this IPS shall be subject to the following limitations:

- i. EPF Department is prohibited from engaging in margin trading and short selling.
- ii. EPF Department is not permitted to leverage the EPF portfolio.
- iii. EPF Department is not permitted to borrow money for investments.
- iv. EPF Department is not permitted to engage in Reverse Repurchase agreements against securities other than Government securities.
- v. EPF Department should not engage in investments with the sole/primary objective of active buying and selling.

## **15. Risk Management**

The EPF fund management activities are subject to the policies set out in the Risk Management Policy Statement of the CBSL, which consist actions pertinent to mitigating the impacts arising from credit, market, liquidity and operational risks.

## **16. Management/Risk Reporting**

EPF shall adhere to the specified periodical reporting to the various committees such as EIOC, NFRMC, BROCC and the MB. Similarly, the RMD shall report periodically to the MB on the risk profile and performance of the portfolio.

## **17. Other Risk and Investment Considerations**

Investments in any entity should be made in accordance with the respective regulations applicable in those entities. Further, all investment decisions would be taken independently in order to ensure no conflict of interest.

## **18. Periodic Review of the Investment Policy Statement**

The IPS will be reviewed at least once a year. Changes to this policy can be made only by the MB, on the recommendation of BROCC.

## **19. External Reporting on the Management of EPF**

The EPF Department shall release to the public key financial highlights (unaudited), within 6 months of the end of the calendar year.

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