

**EVOLUTION OF THE BANGLADESHI PROVIDENT FUND AND ITS
INVESTMENT: TOWARDS AN INDEPENDENT TRUSTEE**

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ABSTRACT

This thesis seeks to address the legal deficiencies in the Bangladeshi Provident Fund identified by the World Bank and the Asian Development Bank in their reports, both published in 1997. This particular fund is currently the only pension fund available in Bangladesh. It is available only to public sector employees and a limited number of people working in the private sector. Under the Trusts Act, 1882, the Provident Fund is administered by the government and certain other employers themselves as trustees, but this has created a conflict of interest between the employers and employees. The World Bank, the Asian Development Bank and the International Organisation of Pension Supervisors have all noted glaring deficiencies firstly in the legislative, regulatory and government administration framework of the Provident Fund under the outdated Trusts Act of 1882, and secondly, in 'nascent' institutions such as insurance companies, which have the potential to offer general pension plans. These problems have hindered Bangladesh in establishing and administering a more universally accessible fund founded upon the 'three pillars' of the modern pension fund scheme recommended by the World Bank in 1994.

This thesis argues that fundamental improvements in trust law and the regulatory framework are needed in order to improve the foundations of the Provident Fund itself, and to make available to all Bangladeshi workers a universal pension fund system - the 'three pillars' pension system. The thesis employs a comparative analysis, drawing on Australia's experience as an established 'three-pillar' pension and superannuation fund system, and India's recent legislative steps towards a three-pillar system. In addressing the problems identified by the above-mentioned international bodies, it is argued here that the crucial step in improving and extending the existing Provident Fund and in establishing a more universally accessible pension fund to create an independent corporate trustee of the pension fund. The trustee of this fund should be independent of the government and employers' administration and control. Because of the independence of this trustee, it will be necessary to provide also an independent regulatory framework for the pension fund's corporate and prudential supervision. These are the essential elements of the 'three-pillar' pension system. Resolving these issues should provide the means for creating an independently regulated pension fund that provides a significant new addition to the social welfare net in Bangladesh. It will also provide a valuable foundation for capital formation in both the domestic and international markets.

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The laws of Bangladesh and the Commonwealth of Australia referred to in the thesis reflect the relevant law as at 25 January 2012.

Md Shamim Alam

25 January 2012

ACKNOWLEDGMENT OF COPYRIGHT

Whilst every care has been taken to establish and acknowledge copyright, I apologise for any accidental infringement of copyright laws in Bangladesh and elsewhere.

TABLE OF ABBREVIATIONS

ACCC	Australian Competition and Consumer Commission
ADB	Asian Development Bank
ADI	Authorised Deposit Taking Institutions
APRA	Australian Prudential Regulatory Authority
ASIC	Australian Securities and Exchange Commission
ASX	Australian Stock Exchange
BDT	Bangladeshi Taka (Currency)
CIT	Commissioners of Income Tax
CPF	Contributory Provident Fund
Cth	Commonwealth of Australia
DB	Defined Benefit
DC	Defined Contribution
DOI	Department of Insurance
EDLI	The Employees' Deposit linked Insurance
EPF	Employees' Provident Fund
EPFO	Employees' Provident Fund Organisation
EPS	Employees' Pension Scheme
FUM	Fund under Management
GDP	Gross Domestic Product

GFM	Global Financial Markets
GPF	General Provident Fund
GPS	Government Pension Scheme
HQ	Headquarters
ICB	Institute of Certified Bookkeepers
IIM	Individual Indian Monetary Trust
IMF	International Monetary Fund
IOPS	International Organisation of Pension Supervisors
IOSCO	Organisation of Securities Commission
IRA	Insurance Regulatory Authority
IRDA	Insurance Regulatory Development Authority
LIC	Life Insurance Corporation of India
MIA	Managed Investment Act
MOC	Ministry of Commerce
NBR	National Board of Revenue
NGO	Non-Government Organisation
NPRS	National Poverty Reduction Strategy
NPS	New Pension System
OAPF	Old Age Pension Fund
OECD	Organisation for Economic Cooperation and Development
PAYG	Pay-as-you-go

PFRDA	Pension Fund Regulatory Development Authority
PIP	People in Profit
PPF	Public Pension Fund
PPO	Pension Payment Order
SBI	State Bank of India
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission
SIS	Superannuation Industry (Supervision) Act
SMSF	Self Managed Superannuation Fund
SRS	Supplementary Retirement Scheme
SWF	Sovereign Wealth Fund
TA	Technical assistance
TIB	Transparency International Bangladesh
UK	United Kingdom
USA	United States of America
VAT	Value Added Tax
WB	World Bank

CHAPTER SUMMARY

This thesis consists of 8 substantive chapters. The research has been organised into three major parts, namely:

Part I - The thesis and a universally accessible Pension Fund for Bangladesh

Chapter 1: The Thesis and the Research

Chapter 2: The Need for a Universally Accessible Pension Fund in Bangladesh

Part II - Failings of the current system and context for change

Chapter 3: Identified Failings in Bangladesh as Reported by the Asian Development Bank

Chapter 4: Context for Implementing WB and ADB Proposals

Chapter 5: Models for the World Bank's Three-Pillar System: Comparisons with India and Australia

Part III - The way forward to by using the World Bank's 'three-pillar' pension model

Chapter 6: Developing Nascent Institutions with Trust Law in Bangladesh

Chapter 7: Regulatory Framework for a Universal Pension Fund

Chapter 8: Recommendations

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CHAPTER 1: THE THESIS AND THE RESEARCH

1. INTRODUCTION

In this thesis, the author examines the legal deficiencies in the Bangladeshi Provident Fund that were identified by the World Bank (WB) and the Asian Development Bank (ADB) in their reports in 1997. It also explores the potential for fundamental improvements in the legal foundation and regulatory framework for the Bangladeshi Provident Fund. In their reports the WB, ADB and the International Organisation of Pension Supervisors (IOPS) all noted deficiencies in nascent trust institutions and government administration arising from deficiencies associated with the outdated *Trusts Act* of 1882.

These problems have hindered Bangladesh in establishing and administering a more universally accessible fund founded on the ‘three pillars’ of the modern pension fund scheme recommended by the WB in 1994. The problems identified by the WB and ADB have led to the four primary questions for research pursued by the author in this thesis:

1. How should the existing Bangladeshi Provident Fund be legally organized and regulated so as to better distinguish the interests of the government and the interests of government employees and fund members?
2. How might Bangladesh create a new pension fund available to a wider range of employees and others that is separate from the government’s existing Provident Fund? While the government’s continuing influence is vital for the security of such a fund and upholding public confidence in the fund, government influence makes it difficult for the fund to be independently managed, invested and accountable.
3. Assuming that it is found desirable to create a separate and independent pension fund, how should such a fund be legally organized and regulated? The important subsidiary question underlying research questions one and two is whether existing principles of trust law might be utilized and developed to ensure the effective management, investment and accountability of the fund; and

4. How should Bangladesh ensure that any separate and independent trust fund is then effectively supervised and regulated? An important related question, assuming that a separate fund is established, how can Bangladesh might ensure that as many citizens as possible are able to contribute to the fund and access its benefits?

Each of these questions raises complex issues and subsidiary questions for research. For example, relinquishing some government control might be expected in order to promote the most profitable investment of the Provident Fund. In this context significant problems in trust administration and investment of the fund need to be resolved. An outdated and misunderstood trust law will also need attention. The extreme poverty in Bangladesh and severe unemployment also inhibits the development of a separate fund. In practice, a nascent insurance industry, with trustees and fund managers lacking experience in international investment, restricts the potential benefits from establishing the fund and an under-developed market undermines the value of a superannuation fund for investment in Bangladesh. Moreover, answering these questions does not necessarily provide the answers for the future. Following the recent global financial crisis and poor investment market returns, the question remains - should Bangladesh still copy the Western model uncritically?

In seeking solutions to these identified problems, this thesis draws particularly on two models: firstly, Australia's development of a relatively advanced 'three-pillar' pension and superannuation fund system; and secondly, a comparative study of India's legislative progress in developing its three-pillar system. To assist in identifying the way forward for Bangladesh, the thesis concludes that while reforms in the Bangladeshi trust law seem essential to the further development of a three-pillar Bangladeshi pension fund system, it will be necessary to separate the administrative and regulatory roles. Resolving these issues to create a better social welfare net in Bangladesh, and lay a valuable foundation for capital formation for both the domestic and international markets.

1.2 THE THESIS

The underlying argument here is that, following the pension system revolution, the “Three Pillars” model proposed by the WB in 1994¹ provides a valuable theoretical and more importantly, practical multi-pillar framework that Bangladesh can implement. This framework should consist of: firstly, a publicly managed, tax-financed pension system; secondly, a privately managed, funded scheme; and thirdly, a voluntary retirement savings system to refine both the role of the Bangladeshi Provident Fund trustee in corporate law and governance. Bangladesh needs to adopt this system because it must resolve the social and constitutional burden of its elderly and retired people.² It must also raise capital for investment in both the domestic and international markets.³

Although in 1994 the WB advised that this model should be implemented in order to strengthen the administration of pension system, Bangladesh has not done so due to its unsatisfactory regulatory and governance practices.⁴ The reality is that Bangladesh has an inadequate welfare system, extreme poverty, a traditionally legalistic framework in which the pension and provident funds operate, and its citizens’ level of income means that this model will be difficult to establish in Bangladesh. However, the critical aspects of the “three-pillar” system, as argued in this thesis, might now be introduced owing to a changing demography, the fact that the country’s wealth is increasing and therefore enabling contributions to a pension fund to be made, a developing trust law, and growing respect for corporate governance. The thesis argues that the government of Bangladesh will feel less budgetary pressure in providing pension benefits to the people and now has the opportunity to create domestic capital.

¹ World Bank’s Policy research report *Averting the Old Age Crisis: policies to protect the old and promote growth* (1994), which offered a more detailed description of a multi-pillar pension framework.

² Article 15 of the Bangladesh Constitution reads:

Provision of basic necessities: It shall be a fundamental responsibility of the State to attain, through planned economic growth, a constant increase of productive forces and a steady improvement in the material and cultural standard of living of the people, with a view to securing to its citizens:

- (a) the provision of the basic necessities of life, including food, clothing, shelter, education and medical care;
- (b) the right to work, that is the right to guaranteed employment at a reasonable wage having regard to the quantity and quality of work;
- (c) the right to reasonable rest, recreation and leisure; and
- (d) the right to social security, that is to say, to public assistance in cases of undeserved want arising from unemployment, illness or disablement, or suffered by widows or orphans or in old age, or in other such cases.

³ Langevoort, D (2008) ‘U.S Securities Regulation and Global Competition’, 12 *Georgetown University Law Centre* 89.

⁴ Asian Development Bank (ADB) (1997) ‘Reformation of Pension and Provident Funds of Bangladesh,’ Asian Development Bank’s Report, Technical Assistant Documents Database of World Bank. <<http://www.worldbank.org>>.

The thesis argues that a critical step in developing the fund, at the least in the longer term, will be the establishment of an independent trustee (see Chapter 6) and a separate regulator (see Chapter 7). The author suggests that while the Australian model may provide some long-term guidance, India provides important short-term lessons in dealing with similar problems faced by Bangladesh and recent developments in that country provide very helpful guidance. In particular, the idea of a specific regulator for pension and superannuation funds such as the Pension Fund Regulatory Development Authority in India (PFRDA) is an important intermediate step for Bangladesh. On the other hand, a prudential regulator such as the Australian Prudential Regulatory Authority (APRA) seems an inevitable longer term development and might be introduced sooner rather than later. Australia provides a good model for the investment of funds domestically and internationally. If not the Australian model, then the Bangladeshi government might consider following the Singaporean model example in directing the investment of the Provident Fund internationally.

1.3 OUTLINE OF THE THESIS

Chapter 1 provides the historical background and research that support the thesis. The chapter discusses the reports of the WB and the ADB with reference to the Bangladeshi pension and provident funds. In Chapter 2 the need for a pension fund in Bangladesh which is accessible to citizens other than government employees is considered. In this way, a universally accessible pension fund might serve to develop wealth and improve living standards in Bangladesh. Chapter 3 examines the failings of the Bangladeshi Provident Fund and shortcomings in provident and pension fund administration as identified by the ADB and WB.

In Chapter 4 the thesis considers the implementation of the WB and ADB's proposals in Bangladesh and in particular establishing a universally accessible pension system within a sophisticated legal and regulatory framework. This context requires a consideration of the legal, administrative and regulatory framework in Bangladesh. Chapter 5 compares different frameworks for a sophisticated modern pension fund system. The chapter considers the developed Australian "three-pillar" model, the developing Indian model, and the state-led Singaporean model to provide insights on developing a pension fund that best serves both

Bangladeshi public and private sector employees. Chapter 6 considers the development of nascent financial institutions in Bangladesh which might encourage national savings for investment in Bangladesh. Among these institutions are pension and investment funds, for which a modern trust concept is central but under-developed in Bangladesh. Both the WB and ADB considered these financial institutions as being central to improving economic equality, fairness and social justice. Chapter 7 discusses the different pension fund regulatory systems of Australia and India and its investment, concluding that a three-pillar system will serve Bangladesh most effectively in the long-term.

The thesis argues that the development of a pension fund system, founded upon clearer concepts of trust law, effectively administered within a three-pillar regulatory framework and widely available to all employees, will greatly extend the capacity of existing Bangladeshi Provident Fund to organise national savings for investment in both the domestic and international capital markets.

1.4 RESEARCH FOR THE THESIS

This thesis examines the deficiencies in the Bangladeshi Provident Fund identified by the WB and the ADB in their 1997 reports. It explores the potential for fundamental improvements in the living standards and welfare of the Bangladeshi people that may derive from an improved Provident Fund. In this respect, the thesis builds on the work of the Nobel Prize winner, Dr Yunus, who advocates mobilisation of savings for capital investment in Bangladesh.⁵ This thesis comprises six substantive research-based chapters as follows;

Chapter 2 considers firstly, the potential value of developing a new pension fund that might be made available to a wider range of employees and others for the accumulation of savings and their investment, in the interest of capital and wealth creation. Chapter 2 considers also the importance and national significance of the findings of the WB, ADB and IOPS to the Bangladeshi Provident Fund and to the development of a more universally accessible pension fund. The author considers the WB's leading role in pension fund reform by proposing a very

⁵ Amin, R (2007) *Grameen Micro-Credit to Grameen Kalyan Health Program*. 1st ed., Dhaka: Academic Press and Publishers Library.

specific definition of a multi-pillar pension scheme. Such a scheme ‘ideally’ would consist of: (i) a mandated unfunded Defined Benefit (DB) system which is publicly managed and in charge of the poverty alleviation objective; (ii) a mandated funded Defined Contribution (DC) system which is privately managed and in charge of the income replacement objective; and (iii) voluntary and funded retirement provisions to compensate for any perceived retirement income gap for individuals, particularly at the higher income end.⁶

Chapter 3 considers the reports of world institutional bodies such as the WB and the ADB which identified a number of deficiencies in the Bangladeshi pension fund system and impediments to the pension fund’s further development. These reports make various recommendations concerning the Bangladeshi Pension and Provident Fund System.⁷ Chapter 3 examines in further detail the specific findings of these reports and concludes that the major deficiencies are: firstly, weaknesses within the Ministry of Commerce (MOC);⁸ secondly, weaknesses of pension funds and insurance companies because they constitute nascent financial institutions in Bangladesh;⁹ thirdly, regulatory weaknesses;¹⁰ and fourthly, corporate governance weaknesses.¹¹ The thesis explores these weaknesses in more detail in subsequent chapters.

Chapter 4 examines the context for implementing the WB and ADB proposals in the light of legal administrative and regulatory framework problems concerning the pension fund system of Bangladesh, and the historical reasons for them. One important historical development, considered in greater detail in Chapter 6, is that new trust and corporate law principles, more in keeping with modern times, have been superimposed on the old 1882 *Trusts Act*. This chapter raises new questions as to how old and new laws might effectively sit together – for example, should the modern legal administrative and regulatory system in Bangladesh be applied to

⁶ Holzmann, R (2000) ‘The World Bank Approach to Pension Reform’, 11-35 *International Social Security Review* 53(1).

⁷ ADB (Asian Development Bank) (2001) ‘Technical Assistance Completion Report on Reform of Pension and Provident Funds’, Manila, 23 July <<http://www.adb.org>> and Asian Development Bank, ‘Technical Assistance to Bangladesh for Preparing the Pension and Insurance Sector Project’, January 2001. <<http://www.adb.org/documents/tars/ban/r12-01>>.

⁸ Asian Development Bank (ADB) (1993) ‘Reformation of Pension and Provident Funds of Bangladesh’, Asian Development Bank’s Report, Technical Assistant Documents Database, World Bank, 10 September <<http://www.worldbank.org>>.

⁹ Asian Development Bank, ‘Technical Assistance Loan: Improvement of Capital Market and Insurance Governance Project (Bangladesh)’, Project No. BAN 36197, March 2008. <<http://www.adb.org/documents/pams/ban/36197-ban-pam>>.

¹⁰ Asian Development Bank, ‘Technical Assistance to Bangladesh for Preparing the Pension and Insurance Sector Project’, January 2001. <<http://www.adb.org/documents/tars/ban/r12-01>>.

¹¹ Asian Development Bank (ADB) (1997) ‘Reformation of Pension and Provident Funds of Bangladesh,’ Asian Development Bank’s Report, Technical Assistant Documents Database of World Bank. <<http://www.worldbank.org>>.

pension funds within the corporate framework? Should insurance law be modernised to cover the loss of investor annuity and any beneficiary's interests in pension funds investment?

These issues are considered in Chapter 4, suggesting that some of the most important steps towards modernising the Bangladeshi system within which pension fund law might develop include: firstly, the establishment of an independent trustee as part of the second pillar; secondly, the establishment of new corporate vehicles such as managed investment schemes for the investment of funds; and thirdly, the establishment of a broader regulatory system for the regulation of corporate entities within the system. These possibilities are considered more fully in Chapters 6 and 7.

Chapter 5 examines in detail the WB's three-pillar pension system and the extent to which the three pillars might be advanced in Bangladesh.¹² The thesis argues that implementing the three pillars will ultimately reduce that country's entrenched poverty, improve national savings and lead to the marshalling of pension funds for investment. However, implementing these three pillars will require major structural change.

In considering the implementation of a three-pillar regime in Bangladesh, the author looks to two other relevant jurisdictions for guidance. There is little such guidance currently available in Bangladesh as to the establishment of the first pillar in the public sector while the second and third pillars are presently non-existent. By comparison, Australia provides one example of a well-established three-pillar superannuation fund regime and India provides ready guidance as to the implementation of co-contributory provident funds – a first step towards the universally accessible fund. India has recently gone some distance towards implementing the WB's recommendations on the second and third pillars. For example India has already undertaken a significant review of its older trust law and established a fresh regulatory regime. For these reasons, India provides a natural model that Bangladesh should consider.

Chapter 6 examines in detail the issues arising from the weaknesses identified by the WB with respect to pension funds and insurance companies as nascent financial institutions in Bangladesh. The weaknesses in Bangladeshi trust law, administration and regulation are described. One

¹² World Bank (2006) *Pension Reform and the Development of Pension Systems: An Evaluation of World Bank Assistance*, Washington, D.C.

immediate concern is the lack of an independent trustee and regulatory framework within which it might operate. This is because the Provident Fund operates only as a government-sponsored fund. Due to the weakness of trust investment law in Bangladesh, and a general lack of confidence in the trustee of private mutual funds, there is a marked lack of investment contribution from the Bangladeshi people themselves with respect to their own future retirement.¹³ For this reason the pension and provident funds law is weak, in that it currently cannot support a robust pension fund system in Bangladesh. A robust system is one which would be a universally accessible pension fund, effectively marshalled for investment and directed to capital-raising – both within Bangladesh and internationally.

In reality, the pension and provident funds in Bangladesh are centralised and that is why there is no substantial choice of investment portfolio management within a regulatory framework. Notions of portfolio investment and diversified risk management strategies in the investment of pension funds are poorly understood in Bangladesh and remain greatly under-developed. The absence of satisfactory guidelines for diversified prudential investment is an important factor in achieving poor investment returns on invested pension funds. This restricts the opportunity for Bangladesh to benefit from investments in international financial markets, where the rate of return might be higher than the fixed interest paid by the government in a pay-as-you-go pension system. In Bangladesh, the rate of return is relatively low and there is a high rate of pre-retirement withdrawals.¹⁴

The current system is actually decreasing investment diversification.¹⁵ Additionally, it fails to reach the vast majority of the population, and no safety net exists for those who are not covered. Moreover, members of this group have far lower incomes while they are working and far fewer resources on which to live in retirement. In practice, net contributions of benefits become inequitable when the results of compensatory structural decisions are set aside and differences are imposed by government regulation. There is also a risk of misappropriation of funds and lack of

¹³ IMF (2009) 'Bangladesh-Assessment Letter for the Asian Development Bank', *Contribution to the World Summit on Social Development*. Washington: IMF

¹⁴ Sayeed, Y (2002) 'Historical impediments in development of a debt securities market in Bangladesh', Report for AIMS of Bangladesh Limited, 4 June <<http://www.aims-bangladesh.com>>.

¹⁵ Mahmud, W (2003) 'Bangladesh: Development Outcomes and Challenges in the Context of Globalization', World Bank Conference, Yale University, 10-11 October <<http://www.ycsg.yale.edu/activities/files/Wahid.doc>>.

disclosure of market or portfolio standards in Bangladesh. Due to the lack of basic legal infrastructure, pension rights in Bangladesh are not portable.¹⁶

The present legal infrastructure of Bangladesh does not provide investment options or freedom of investment access which would bring improved investment returns for pension beneficiaries. There are no prudent investment management systems which increase the rate of returns.¹⁷ In addition, premature withdrawals are freely available. Neither trustee-managed pension funds nor funded gratuity plans are supervised by any statutory body, and the data on their operations are available only with a substantial delay. There is a common weak regulatory environment, including long delays in processing claims, lack of accountability for crediting interest to members, and lack of transparency in issuing annual account statements. At the same time, investors' rights are not well secured by the financial regulations because there is no market confidence regulated by the authority.¹⁸

In the past, the Bangladeshi pension system worked as a fragmentary regulatory framework, beset by lack of individual choice, portability and uniform standards. There were few pension schemes before 1995. Introduced in 1996, the defined contributory provident fund scheme featured entitlement of a pension for life to the member's spouse on the death of that member. It is necessary for Bangladesh to adopt international principles and practices in its pension and provident funds system.

Due to the non-adoption of those international principles and practices, rates of return required to adequately provide for pension fund beneficiaries may be difficult to achieve if investment remains solely within Bangladesh. These failings also mean that Bangladesh will, in the longer term, lose the opportunity to develop valuable expertise in international corporate investment and portfolio investment management generally. In so far as this form of international investment has also become the most significant source of capital for corporations worldwide, the underdevelopment of the Bangladeshi Provident Fund will, in time, deny vital capital for Bangladeshi corporations. It will also deny the further development of the principles of corporate law and governance that have been largely fashioned by the worldwide pension fund revolution

¹⁶ Sayeed, Y. note 13.

¹⁷ World Bank (2006), note 12.

¹⁸ Staff Correspondent (2008) 'Pay Bribe, Get Pension', *The Daily Star*, 26 August, 1.

through the three-pillar framework.¹⁹ Implementing the three-pillar system, as recommended by the WB, would result in the universally accessible pension fund system being realised in Bangladesh for the greatest good. A universally accessible pension fund system is defined as a pension fund system which is accessible by every citizen of Bangladesh, irrespective of social or employment status.

A universally accessible pension fund system would accord with s 15 of the Bangladeshi Constitution, which provides that the State shall, amongst other things, bear responsibility for planned economic growth and material wellbeing with the view to securing its citizens. In particular, sub-section 15(d) of the Constitution provides for the citizens' right to social security, and to public assistance from undeserved want arising from unemployment, illness or disablement. Essentially, the State is responsible for ensuring steady improvement in the people's material and cultural standard of living. The author envisages this universally accessible pension fund system, will meet the legal demands imposed upon the State under the Constitution.

In Chapter 6, the author considers, firstly, the benefits of an independent trustee as the foundation stone for a broader, more accessible pension fund system in Bangladesh, in accordance with the WB's second and third pillars. The author's suggestion would be that the government, utilising accumulated experience in the administration of the Provident Fund since 1982, could consider the legal structure of an independent trustee with three main objects in mind: firstly, loosening the present restrictions on the investment of the provident fund; secondly, attracting a more general membership to the fund (i.e. not just government employees); and thirdly, devising a taxation and regulatory system to supervise these developments.

Trust law in Bangladesh is vital to marshalling national savings for investment by implementing a transparent legal regime. Where and when this occurs, it is more than likely that Bangladeshi citizens will invest for their future in pension funds. Nascent institutions' practices when more fully developed will provide a safeguard for any funds coming under the trust law and regulation will encourage people to exercise personal trust in how pension and provident funds investment will operate. With this theme in mind, Australian law and practice is referred to by providing

¹⁹ IMF (2010) 'Bangladesh: Selected Issues of Market-Sensitive Information', *Contribution to the World Summit on Social Development*. Washington: IMF.

examples of the way in which the Bangladeshi system might be extended and developed. At the same time, the author also draws on the lessons learnt from India which has recently reviewed its older trust law (which incidentally is the same trust law operating in Bangladesh) and introduced a new regulatory regime.

The author argues, in Chapter 6, that the development of an independent and respected trustee which is properly regulated will be critical to maintaining public confidence in a more universally accessible pension fund. A difficult question here is the extent and degree of control retained by the government. At one extreme the Bangladeshi government may adopt the Singaporean model and take charge of what is known as a Sovereign Wealth Fund (SWF) to be invested internationally. However, as discussed in Chapter 5, travelling along this route would negate the potential for developing the second and third pillars. On the other hand, an independent trustee will undoubtedly require safeguards against private conflicts of interest when the fund is invested domestically.

Chapter 7 considers the mechanisms available within the trustee's investment powers and corporate governance for the organisation responsible for the investment; the investment's organisation of trust funds. In Chapter 7, the importance of a regulatory framework for a universal pension fund is considered. By comparing Australian and Indian corporate regulators, this chapter shows that Bangladesh might consider the separate and independent regulatory system to establish a secured pension fund within a trust framework. Recommendations are made along with possible solutions based on empirical research which enables existing weaknesses for building and investing in the pension fund of Bangladesh to be overcome. At issue is how a pension fund can invest as a trust fund both domestically and internationally so that it provides higher rates of return to the trust fund's beneficiaries.

1.5 RATIONALE FOR THE RESEARCH AND ITS VALUE

The immediate rationale of this research lies in to the need to solve the problems highlighted by the WB and ADB, and this means closely examining weaknesses in nascent institutions' administration of trusts and their investment decisions. A longer term rationale for extending the reach of the Bangladeshi Provident Fund (and for the research undertaken in this thesis) is that a

universal pension fund makes wealth creation available to all Bangladeshi citizens and provides a fund for domestic capital and its investment internationally. The growth of pension funds internationally now connects the law associated with pension and superannuation funds with the law relating to investment management, and therefore with access to world capital markets, but this has not yet occurred in Bangladesh. The value of the research lies in its contribution to developing a fund that can invest domestically and internationally.

This research will bring the benefits in legal and economic philosophy of social justice, social welfare, reducing poverty and improving opportunity to build a stable and safe economy for Bangladeshi citizens. Academically, the value of this research lies in its use of methodologies in original legal research, comparative and empirical studies to greatly extend our understanding of the weaknesses in the Bangladeshi Provident Fund that the WB and ADB identified. To date, the underlying legal, political and social difficulties associated with nascent institutions such as insurance companies in Bangladesh have never been fully examined. Primarily, these difficulties include the absence of a modern trust law, an independent trustee for the provident fund and independent regulation. The author explores these possibilities in Chapters 6 and 7. At the same time the author recognizes that India has made progress on these fronts in a similar context and that Bangladesh has much to learn from this (see Chapter 5). The value of the author's research lies in exploring the legal, administrative and practical weaknesses of the Bangladeshi Provident Fund so that a more universally available fund can be developed and regulated. Only then will Bangladesh build on this foundation as a source of domestic capital and for future investment internationally.

1.6 AIM OF THE RESEARCH

The WB and the ADB in their reports published in 1997 on the Bangladeshi Provident Fund and insurance industry noted the legal deficiencies and lack of investment expertise. The aim of this research is to discover the best solutions to overcome the institutional and administrative problems in Bangladesh's pension system, by suggesting what has been achieved in more economically developed countries such as Australia. Implementing aspects of these systems will subsequently enable Bangladesh to enter the Global Financial Markets (GFMs).

The research also aims to create an environment of regulatory reformation in Bangladesh so that regulatory obstacles, regulatory arbitrage and legal obsolescence can be removed. It will initiate development in four distinct domains: national savings raising; adopting the ‘three pillar’s pension model for capital utilisation; separation and independence of trustee relationship; and legal frame works. Furthermore this thesis will specifically help to build strong financial opportunities for the people of Bangladesh who are not employed by the government. The research will speak about the optimal investment practice for a superannuation system within a trust regime. The desired policy outcome of the research is an increase in national savings and investment through the worldwide superannuation system, within a sophisticated legal and regulatory corporate framework.

1.7 RESEARCH METHODOLOGY

After identifying the shortcomings as described by the ADB and WB, the author undertakes original legal and comparative research into trust law in three jurisdictions, and historical research to suggest the context in which change and implementation in Bangladesh has and will occur. The best options and empirical evidence from Bangladesh are used to clarify the WB and the ADB’s criticisms. The methodology examines the reports from the ADB and the WB, and in particular the ‘three-pillar’ system promoted by the latter. At the same time, motivated by the aim to find probable solutions, this research takes into consideration the suggestions made by the International Monetary Fund (IMF) and the Guidelines provided by the IOPS.

In reading the ADB report on ‘Insurance Industry and Pension and Provident Fund Reforms’,²⁰ significant weaknesses were brought to the author’s attention, which are presented in various sections of this thesis. In particular, to establish the universally accessible pension fund for Bangladesh, the “three-pillar” system prescribed by the WB was considered here. In the light of the ADB and the WB process, trust law deficiencies are deemed to be a core impediment to developing the provident fund industry so that national savings for investment could be accumulated. The thesis requires original research into the legal, philosophical and religious

²⁰ The ADB Technical Assistance Completion Report, TA 2915-BAN: Insurance and Pension and Provident Fund Reforms, approved date 20 Nov 1997, Completion date Aug 1999, Division: SAGF, Executing Agency: Ministry of Commerce.

dimensions of the problems in order to assess the benefits of social justice and property redistribution, which are argued here as maximising the happiness of the citizens of Bangladesh. This thesis has also noted the original legal basis to establish the trust framework in order to manage the trust fund for investment purposes.

The author has considered the benchmark countries of Australia and Singapore in provident fund investment as having the best management practices for national and international investment. These two countries are regarded as politically and economically stable countries, exercising regulations and providing safeguards for their respective provident funds. India, as a neighbouring country of Bangladesh, is important because it has introduced improvements to its provident fund. India has to be considered here because from the viewpoint of history, it shares with Bangladesh a similar culture and legislative regimes.

To establish recommendations that provide the best solutions and to support the author's findings, a select interview process was undertaken with public, private and autonomous bodies in Bangladesh. A summary of the comments derived from those interviews is attached as an appendix 'A'. The limitations of this research consisted of the lack of published literature and material available for examination and the fact that the interviewees were located offshore. During the literature review and interviews, it emerged that not much research has been done on the provident and pension funds in Bangladesh. It has also been noted that there is a substantial lack of sector-specific empirical and real-life studies. Credible data and relevant information on the pension fund industry concerns in Bangladesh is absent. Therefore, the author relied on the reports published by the ADB and WB.

1.8 CONCLUSION

If, after establishing the institutions recommended to operate the trust funds, and international investment deposits on an experimental basis, will this then reveal the actual rate of return on funds domestically? If so, then transparency can be said to have been established. The trust fund's rate of return on investments in the international domain, having been derived offshore, are viewed by the people of Bangladesh as more secure and accountable due to the intervention of international financial market regulators. To implement this, the Bangladeshi people should

have prudent and highly educated trustees and fund managers who will push the local market to raise the domestic capital for this type of investment strategy. At the same time the incapacity of the trustee and investment law needs to be aggressively defined and reformed as a springboard to attract the largest number of contributors to Bangladesh's pension and provident funds for investment.

Clearly, a difficult underlying question remains how the recommendations developed by the author in the thesis might be applied in the context of the social, administrative and economic conditions prevailing in Bangladesh. The reports of both the WB and ADB reflected the same concern. This underlying question is addressed by the author through references at particular points to his empirical study (Appendix A). In this study the author collated empirical information about how his proposals might be received by senior parliamentarians, public servants, lawyers and academics. This information has been utilized where appropriate throughout the thesis to provide illustrations of the effects and consequences of possible changes in the law. More broadly, in chapter 4, the author sets out the most significant philosophical and religious implications of his proposals.

The author is left with certain questions that require further consideration. One is whether the universally accessible pension fund for all employees and others, necessary for Bangladesh to meet its Constitutional demands for social justice, can be established within a framework adopting the private and independent corporate trustee suggested by IOPS. Such a pension fund will need careful regulation. Particular issues center on how Bangladesh will marshal national savings through the pension funds for investment in domestic and international markets.

Whether or not the "three-pillar" system is appropriate for improving Bangladeshi pension funds in terms of developing a social security net, as has been done by over eighty countries, remains to be demonstrated. Secondly, in demonstrating whether or not the three-pillar system is appropriate, its existence will alleviate the current pressure on the Bangladesh government and organizations to pay fund benefits to pension holders. Available empirical evidence already suggests that the government or an employer itself should not be the trustee when it comes to

exercising an employee's trust fund. To make this type of trust fund workable, Bangladesh should combine international corporate and commercial principles to make it workable.

Even after all the above has been considered, a major issue arises that further demands an answer to the question of how can a secure pension fund be established, along with possible solutions, to provide the kind of transparency necessary to attract investment and to enable corrective measures to be applied to administrative, regulatory and corporate weaknesses. The author views the Australian prudential and regulatory model as an effective basis from which to examine this scenario.

In finding the answers to the above research questions, the research methodology to be employed will include an examination of the Technical Reports from the ADB and the three-pillar system promoted by the WB. The suggestions made by the IMF and the Guidelines provided by the IOPS are also considered. The author will take into account the benchmark countries of Australia and Singapore in provident fund investment, including India - a neighbour country of Bangladesh. Finally, to establish the probable or best solutions in conjunction with a literature review of relative legislative frameworks and case law, selected public, private and autonomous bodies located in Bangladesh were interviewed.

CHAPTER 2: THE NEED FOR A UNIVERSALLY ACCESSIBLE PENSION FUND IN BANGLADESH

2.1 INTRODUCTION

This chapter discusses the theoretical and academic literature which has provided the foundation for the development of pension funds internationally, not merely as a means of providing greater social equality and economic welfare, but also for building capital for investment domestically and internationally. Following this, the chapter reviews the reports of international bodies including the ADB, WB, IOPS and others to identify what these organisations have claimed are necessary for creating a pension fund system in Bangladesh.

The need in Bangladesh for a universally accessible pension fund arises because Bangladeshi citizens need to establish secure funds which might form the basis of national savings for domestic and international investment. Globally and especially in developed countries, pension funds make an important contribution to the marshalling of national savings for investment and capital formation, the objective of which is to reduce the financial burdens associated with an aging population. What the developed countries have achieved in this respect substantiates the national need for Bangladesh to do the same. At present, the Bangladeshi provident and pension funds remain unfunded and have a marked lack of investment power.

A universally accessible fund for savings, investment and wealth creation is required and the reports of the WB, the ADB and the IOPS make various findings and recommendations concerning the Bangladeshi Pension and Provident Fund System.²¹ In this chapter the author considers the importance for developing the Bangladeshi Provident Fund into a more universally accessible pension fund. Furthermore, the World Bank's leading role in pension fund reform is referred to, especially its proposition of a very specific definition of a multi-pillar pension scheme, 'ideally' consisting of: (i) a mandated unfunded Defined Benefit (DB) system which is publicly managed and in charge of the poverty alleviation objective; (ii) a mandated funded Defined Contribution (DC) system which is privately managed and in charge of the income

²¹ ADB (Asian Development Bank) (2001), Note.7

replacement objective; and (iii) voluntary and funded retirement provisions to compensate any perceived retirement income gap for individuals in particular income groups.²²

Additionally, the author notes that the WB and IMF had extensive, ongoing discussions on pension issues, particularly on the fiscal framework,²³ providing evidence of their direct participation in the assessment of the Bangladeshi Financial sector. They suggested reforming the infrastructural investment and social spending program, including guidelines provided by the IOPS to establish pension funds.

Finally, comparisons are made between the Australian and Singaporean pension fund investment systems, with an emphasis on their international growth and capital investment. They are seen providing an impetus to implementing a similar national wealth creation scheme for Bangladesh. The aim is to provide social and economic justice by addressing inherent obstacles to the growth of pension funds in Bangladesh.

2.2 SUPPORT FOR PENSION FUNDS IN SOCIAL JUSTICE, ECONOMICS AND FINANCE

2.2.1 SOCIAL JUSTICE ASPECTS OF PROVIDENT FUNDS

Actively employing provident and pension funds to encourage national savings for investment in developing countries is critical in creating social justice and economic egalitarianism. The adoption of progressive taxation regimes and the income and property redistribution generally associated with stable pension fund systems are also viewed as important elements of social justice.²⁴ Building on the Theory of Social Justice,²⁵ this thesis proposes a theory of economic

²² Holzmann, R (2000), Note.6

²³ IMF (International Monetary Fund) (1995) 'Social Dimensions of Change: The IMF's Policy Dialogue', *Contribution to the World Summit on Social Development*. Washington: IMF.

²⁴ Bentham, J, and Mill, SJ (1861) *The Theory of Utilitarianism*. London: Fraser's Magazine. In the 'Theory of Utilitarianism', Bentham, J (1861: 87-111) describes 'the greatest happiness principle' – the greatest good for the greatest number of people. This principle is known as his principle of utility regarding 'good' as that which produces the greatest amount of pleasure and the minimum amount of pain. Conversely, he regards 'evil' as that which produces the most pain without the pleasure. This concept of pleasure and pain is defined by Bentham as both physical as well as spiritual, manifest within the legislation governing a society.

²⁵ Rawles, J (1971) *A Theory of Social Justice*. Washington: Centre for Economic and Social Justice. In this theory John Rawles identifies that each person possesses inviolability founded on justice that even the welfare of society as a whole cannot override. In the first principle of Social Justice, he proposes that each person is to have an equal right to the most extensive scheme of equal and basic liberties, compatible with a similar scheme of liberties for others. Subsequently, social justice provides a framework to assess the impact of policies and practices, and also provides equitable outcomes to marginalised groups, by recognising past disadvantage and existence of structural barriers embedded in the social, economic and political system that perpetuate systemic

justice in which citizens adopt key principles of participation, distribution and harmony in order to support access to a pension fund as an economic principle. The more humanitarian and egalitarian distribution of wealth achieved through pension and provident funds, for example, is supported by a system of progressive taxation. Access to a universal pension fund system through the encouragement of citizen participation and greater economic opportunity in society, may help to reduce the risk of political upheaval.²⁶

2.2.2 ECONOMIC ASPECTS OF PENSION FUNDS

In 1976, Drucker first considered the social, political and economic impact of pension funds in the United States. He considered, in particular, the rise to power of pension funds as major corporate shareholders and corporate owners.²⁷ Compared to the United States of America (USA), however, participation by the citizens of developing countries in pension and provident funds has been consistently weaker. Increasing this participation in developing countries such as Bangladesh is deemed to be a key element in establishing economic justice.²⁸

2.3 THE INCREASED WEALTH DERIVING FROM PENSION FUNDS

2.3.1 HOW THE INVESTMENT OF PENSION FUNDS INCREASES NATIONAL WEALTH

The pension system in an economy has social as well economic implications; on one hand, funds generated in a pension system provide retirement benefits for the masses and, on the other, these mobilize long-term savings and encourage the development of financial and capital markets. Under the voluntary pension system, the superannuation fund in Bangladesh is very important in

discrimination. The theory of Social Justice is a concept which describes the movement towards a socially just world. In this context it has been seen that social justice is based on the concepts of human rights and equity and involves a greater degree of economic egalitarianism through progressive taxation, income redistribution. The concept also addresses property redistribution, and politics aimed toward achieving that which developmental economists refer to as more equality of opportunity and equality of outcome than may currently exist in some societies, or are available to some classes in a given society.

²⁶ Kelso, L and Hetter, P (1967) *Two-Factor Theory: The Economics of Reality (Kelso Random House.) and Democracy and Economic Power: Extending the ESOP Revolution*. New York: Vintage Books, pp. 19-56.

²⁷ Drucker, PF (1976) *The Unseen Revolution: How Pension Fund Socialism Came to America*. New York: Harper and Row.

²⁸ Kelso, L and Hetter, P (1967) *Two-Factor Theory: The Economics of Reality (Kelso Random House.) and Democracy and Economic Power: Extending the ESOP Revolution*. New York: Vintage Books, pp. 56-67. There are three essential and interdependent principles in this system of economic justice, including the Principle of Participation, the Principle of Distribution, and the Principle of Harmony. Kelso and Hetter have also described the social adjustment process in society as economic harmony.

a working partnership if it is to develop domestic investment opportunities. At the same time it is particularly important to focus public education on the need for self-financing so that an income is available when a person reaches old age.

As investment measures the Bangladeshi Pension and Provident Funds will provide long-term resources for developing utilities and infrastructure, help to strengthen the capital markets through widening the institutional investors' base and introduction of good corporate governance practices, and finally, improve government finances. Introduction of private pension fund managers would ensure the large-scale mobilisation of savings, which would lead to a higher rate of capital accumulation, which is crucial for a developing country like Bangladesh. The SEC of Bangladesh has to make new laws and amend some existing laws or enact a separate law to bring into existence occupational savings schemes including pension funds, gratuities and provident funds which are currently not regulated by any agency. In fact, most of these are still un-funded and there is no reporting requirement for them. If the SEC is able to fill the regulatory gaps and set up appropriate mechanisms to protect the interests of beneficiaries, this will as a consequence turn into a great investment for Bangladesh.

Bangladeshi companies can be requested to share information on their occupational pension schemes so that a database can be built. This database would be helpful in formulating the future policies regarding pension policies in Bangladesh,²⁹ helping to develop an institutional framework for a pension system. It is hoped that pension privatisation would raise the level of savings and investments in Bangladesh. The Grameen Bank in Bangladesh has done one thing correctly; it has led an enormous push in favour of pension accounts. Every borrower is forced to open a pension account and start contributing every month. This encourages preparing for old age, based on thrift and self-help; not an approach of being a supplicant trying to beg for food from a government in old age.³⁰ Banks' operations helped the multi-pillar reformer countries build institutional capacity to strengthen the administration of a tax-financed pension system and the regulation of funded pensions.³¹ Eighty-seven percent of all projects with a pension

²⁹ Seminar on Voluntary Pension System, Speaker Dr. Tariq Hassan, organised by the SEC on 11 August 2005 in Karachi, Pakistan

³⁰ Grameen Bank, Founder Pro. Muhammad Yunus (awarded the Noble Peace Prize in December, 2006). It is the bank which is owned by the borrowers.

³¹ World Bank (2006), note 12.

component and seventy-five percent of pension components were satisfactory in their evaluation outcome.³²

We can observe the strategy of the WB in applying a multi-pillar pension system to those countries that developed sound macro-economic policies and adequate financial sectors. At the same time we also see that the WB supports the countries for reforming the pay-as-you-go (PAYG) system due to their lack of initial conditions of social safety nets in adopting the multi-pillar system. Nonetheless, the ADB and WB encouraged many countries such as Bangladesh, India and Pakistan to adopt a multi-pillar pension system even though there are clear weaknesses in their respective economic, administrative and financial sectors.³³

2.3.2 THE INTERNATIONAL GROWTH OF PENSION FUNDS AND INVESTMENT CAPITAL

In the present global financial market the pensions issue is very important. The public and private sectors' pension funds are both now contributing to the national savings and international financial markets. Most of the countries of Asia-Pacific region are struggling to change their economic and social circumstances by utilising pension and provident funds at their national and international levels. They have started rethinking about this pension agenda due to the influence of the ADB and WB.³⁴ Comparatively speaking, Bangladesh did not satisfy that level of efforts or initiative as the ADB had expected.³⁵

Pension developments in Western countries are well advanced in reaching high target amounts. By investing pension and provident funds they have to date achieved significant pension benefits for many people. Competition laws protect their retail investors from the abuses of limited investment opportunities and monopolistic institutional trading.³⁶ They generate large pension plans which are able to employ sophisticated asset management techniques, and modern portfolio

³² World Bank (2006), note 12.

³³ World Bank (2008) 'An Assessment of Social Safety Nets in Bangladesh'. WB Group: Washington, D.C., 15 November <<http://publications.worldbank.org/e-commerce/>>.

³⁴ Glenn, B (2006) *Developing an Approach to Pension Reform*, Asia-Pacific Region PSI, 12 February <www.world.psi.org>.

³⁵ ADB (1997-2000) 'Reformation of Pension and Provident Funds of Bangladesh', Asian Development Bank's Report, Technical Assistant Documents Database of World Bank. <www.worldbank.org>.

³⁶ Langevoort, D (2008), note 3.

theory in the development and implementation of investment programs.³⁷ It may be problematic whether the same institutional structures and investment techniques will enable pension fund benefits to continue to grow at the same rate in the future. In Bangladesh the public sector has the DB pension system while in the private sector there are very rare facilities for the DC pension system. There is no hybrid plan provided to employees for their retirement income. Nevertheless Bangladesh can accumulate those pension funds from both sectors as a national savings strategy for regulating fund investments.

2.3.3 IMPORTANCE OF PENSION FUNDS TO GOOD CORPORATE GOVERNANCE FOR BANGLADESH

All Asian countries are gradually improving the practice of corporate governance. The facts show that institutional investors are playing a major role in promoting these corporate practices.³⁸ The author believes that the legislative framework and practice proposed for the Bangladeshi Pension and Provident Funds will help build a corporate culture and good corporate governance practice in Bangladesh. It is true that bad corporate practices must be a prime factor for pension beneficiaries losing their trust or faith in trustees. Such funds will become very attractive to decision-makers in relation to market investments. Fund managers control the various risks to exposure and must incorporate risk management into the corporate practices. Fund managers are skillful persons who can easily identify and exploit market inefficiencies to achieve greater margins and obtain the highest rate of return for pension funds. It should be noted here that pension funds sometimes become subject to higher risk when endeavoring to achieve higher returns. Therefore management of that risk must be integrated into all existing planning, operational and reporting processes. Compensation should also be linked to successful risk management. Corporate governance reforms in Asia can be traced back to the destabilising 1997-98 financial crisis. Corporate governance in Asia has converged around these themes in recent

³⁷ Mitchell, S and Twinney, M (1997) *Positioning Pensions for the Twenty-first Century*. USA: University of Pennsylvania Press.

³⁸ Auwera, Vander M (2006) 'Pension Reform and ADB Interventions', Discussion Paper No, 010907. Manila, Philippines: Asian Development Bank, 23 December<www.adb.org>.

years: the importance of independent directors; the need for a strong board committee system; and the value in aligning local accounting and auditing standards with international standards.³⁹

The relationship between government and institutional investors responsible for managing public retirement funds is a critical one. This relationship has been identified in the Organisation for Economic Cooperation and Development (OECD) principles which state:

Corporate governance is one key element in improving efficiency and growth as well as enhancing investor confidence. Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders...these relationships are subject, in part, to law and regulation and, in part, to voluntary adaption and, most importantly, to market forces.⁴⁰

Care must be taken on both sides of the equation that they are appropriately independent and that pension funds, for example, are not manipulated to bail out ailing companies and/or to stabilise a volatile economy.

Most Asian countries lack the ability to create institutional investors, as well as a legal security framework which protects those investors during their business activities and may have an impact on the marketplace. This scenario includes good corporate governance practices and it is the responsibility of government regulators to create a sound environment for institutional investors. On the other hand, foreign investors and financial institutions should be able to implement good corporate governance practices. They utilise the formula of trust practices for enabling companies to provide good returns on investment. However, Asian companies are still in the early stages of fiduciary responsibility and knowing how to deal with conflicts of interest. Sadly, the government regulatory bodies in Asia currently do not enforce the principles of institutional corporate governance.

2.4 VALUE OF PENSION FUNDS IN OTHER COUNTRIES

2.4.1 FUTURE OF THE PENSION FUND INVESTMENT SCHEME OF AUSTRALIA AND SINGAPORE

³⁹ The Structure, Regulation and Performance of Pension Funds in Nine Industrial Countries, E.P. Davis, Policy research working paper 1229, the World Bank, Financial Sector Development Department, Dec 1993. <<http://www.worldbank.org>>.

⁴⁰ Organisation for Economic Co-operation and Development (OECD), Principles of Corporate Governance, Paris: OECD, 2004.

In this section the author reviews the successful examples of pension developments in Australia and Singapore. Australia and Singapore now have well-developed pension fund systems, and are seeing the benefits of having developed a three-pillar pension fund system. Both provide interesting considerations for the nascent Bangladeshi pension fund system. The theoretical political objectives in establishing these funds are very different and should be understood. In Singapore, an important objective in establishing the fund appears to be the marshalling of Singaporean savings for investment internationally.

By contrast, the Australian superannuation system is a well-established and more fully developed three-pillar pension funds system. The pension fund system has been soundly established and administered, and is well regulated.⁴¹ Australia has enjoyed the benefits of a well-regulated corporate and prudential financial system, consistent with the ‘three-pillar approach advocated by the World Bank. Firstly, however, it is valuable to consider briefly the essential advantages that may derive from a centrally controlled superannuation fund, such as that operating in Singapore, particularly when investing internationally. The need for a universally accessible pension fund in Bangladesh, founded upon the ‘Three Pillars’, is supported by the growth of pension funds in other countries.

2.5 REVIEW OF INTERNATIONAL BODIES: BENEFITS, NEEDS AND VALUE OF PENSION FUNDS WITHIN A CORPORATE FRAMEWORK

International organisations such as the ADB, WB, IMF and IOPS are concerned with the pension system of Bangladesh. The population of Bangladesh is aging rapidly and citizens need the pension to support their senior years. The international bodies concluded that the current system will not provide the elderly with the support they require. The recent global financial crisis (GFC) has highlighted the importance of pension funds to social justice, and in reducing the disparity between rich and poor. On that point Bangladesh needs to move away from its past reliance on an unfunded pension system to a funded one and excessive national savings for investment in the domestic and international marketplaces. An effective nation-wide pension fund may provide a

⁴¹ Nicoll, G (2006) *Empowering Australian Superannuation Funds and Investment Managers as Major Corporate Shareholders* (Unpublished thesis) The University of Sydney.

social safety net in Bangladesh.⁴² It is important and crucial for the pension fund to maximise its returns and to do so in a corporate framework that directs investments into schemes, projects and activities that ensure the long-term sustainable development of Bangladeshi economy.⁴³

2.5.1 THE WORLD BANK AND ASIAN DEVELOPMENT BANK AND THEIR STANDARDS

The following discussion incorporates both recommendations and a broad approach to pension funds for the developing world, involving a pension fund reform proposal by the WB for a very specific multi-pillar pension scheme. The ADB 1997 report⁴⁴ concluded that the regulator of the Bangladesh insurance and pension industry, the MOC⁴⁵, was institutionally very weak. This is contrary to the Australian experience, where APRA provides safeguards through the diligent enforcement of statutory and regulatory requirements imposed on superannuation fund trustees and financial service providers. The ADB report concerning Bangladesh identified inherent weaknesses arising particularly from a severe shortage of qualified staff, poor leadership, deficiencies in the organisation, policies and procedures, and inadequate support from the MOC and the government itself.

The report compared documentary evidence of both public and private sector General Provident Fund (GPF) and Contributory Provident Fund (CPF) structures under the *Provident Fund Rules* 1979.⁴⁶ In the GPF scheme, all government employees who are not required or permitted to subscribe to the CPF shall be eligible to join the fund as compulsory subscribers until their retirement. On the other hand the CPF is administered by the government for non-pensionable government employees where the government contributes an equal amount as the subscriber does. A few private sector firms have recently started their own CPF system.⁴⁷

⁴² Asian Development Bank (2001), note 7.

⁴³ Asian Development Bank (2009), *The Time to Lead is Now: The Adoption of ESG Analysis by Asia Government Pension Funds*, Association for Sustainable and Responsible Investment in Asia (ASrIA). <<http://www.asria.org>>.

⁴⁴ TA 2915-BAN (1997) 'Insurance and Pension and Provident Fund Reforms of Bangladesh', Technical Assistance Completion Report, Asian Development Bank, 14 July <www.worldbank.org>.

⁴⁵ Asian Development Bank (ADB) (2000) 'Reformation of Pension and Provident Funds of Bangladesh', Asian Development Bank's Report, Technical Assistant Documents Database, World Bank. <www.worldbank.org>. Note that as part of the Ministry of Commerce, the Department of Insurance has responsibility for administration of the Pension and Insurance Fund.

⁴⁶ MF(RU)-1(5)/79/28 & MF(RU)-1(5)/79/29, published in the Bangladesh Gazette, Extraordinary, dated 20 August 1979.

⁴⁷ Hassan, M (2007) 'Country Statement of Bangladesh on High-level meeting on the Regional Review of the Madrid International Plan of Action on Ageing (MIPAA)' 9-11 October, Macao, China.

Both schemes were purposely established as trust funds, yet their allowable tax deductions and incentives are subject to approval by the National Board of Revenue (NBR) under the *Income Tax Ordinance*, 1995. Similarly, it was found that full participation and active investment deposits in the capital markets was restricted by virtue of the *Trusts Act*, 1882 of Bangladesh to 25% of trust money under section 20B(1). The effect of such a restriction significantly limits the scope for investment deposits to only the Bangladesh government and government-approved securities. As a flow-on effect, furthermore, it has been argued that due to a lack of experienced investment managers in the Bangladesh public and private corporate governance sector, this has led to significant failures in the insurance industry and trust law, and regulations concerning pension fund investment. As a consequence of the inherent weaknesses outlined in the report, advice was provided by the ADB⁴⁸ about financing those schemes. Although the advice has been acknowledged, it has not yet been implemented.

2.5.2 THE WORLD BANK'S THREE PILLARS

The title 'Three-Pillar' system which the WB has introduced is also known by other authors as a 'Multi-Pillar' system. These two titles mean the same thing but are approached from different perspectives. Some authors add to the three-pillar concept, and devise a multi-pillar model to reform a pension system. As an acknowledged leader and originator of the three-pillar model, the WB assists countries to ensure that their pension systems are adequate, affordable, sustainable and robust.⁴⁹ In defining a multi-pillar scheme the WB presented an 'ideal' three-pillar system which comprises a publicly managed scheme having the objective of alleviating poverty, as well as a privately managed system for income replacement, and also a voluntary system to fund retirement and perceived retirement income gap levels for all citizens.⁵⁰ However, because of the way in which this approach is applied, it is argued⁵¹ that macroeconomic instability has infiltrated

⁴⁸ Other international banks having an active interest in the scheme's reconstruction and development also provided advice.

⁴⁹ Holzmann, R (2000), note 6.

⁵⁰ Holzmann, R and Hinz, R (2005) 'Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform', Washington, D.C.: World Bank, 23 February <www.info.worldbank.org>.

⁵¹ Hassan, M (2007), note 44.

the Bangladeshi pension and provident funds system, constraining economic growth and turning the 'ideal' system into an ineffective and/or inequitable provider of retirement income.⁵²

Although the public service in Bangladesh attempts to pursue the 'ideal' objective of poverty alleviation as recommended by the WB as the first pillar, in reality the redistribution and social safety net programmes do not directly provide the necessary basic support for everyone in Bangladesh. To illustrate where this 'ideal' falls short, many countries have extended the first pillar well beyond the required basic re-distributive function to establish social justice by allocating a significant portion of derived investment income for retirement benefits even to the poor.

In contrast, the privately managed second pillar 'ideal' - mandated contribution - does have its advantages. Firstly, advantages flowing to owners of retirement plans arising from competitively managed pension funds are more likely to receive maximised investment returns, with reduced risks to the beneficiaries.⁵³ However, even though this 'ideal' from the WB point of view is very advantageous for many Bangladeshi pension and provident fund beneficiaries, the realisation of any such advantage under a scheme of the 'greatest good for the greatest number' which 'maximises the greatest happiness', has not yet happened.⁵⁴ In Bangladesh, the second pillar is still to be firmly established in the private sector, so as to provide individuals who have a lack of sufficient personal income, with a retirement income.⁵⁵ The income provided in retirement under the second pillar, must be at levels acceptable and necessary to alleviate the costly financial burden of care and respite of the individual as they become elderly, aged and frail.

The third pillar, as a voluntary system for funding retirement and perceived retirement income gap levels for all citizens, is in almost all variations of this model, voluntary, a fully funded, and privately managed trust fund. This is similar to the Self Managed Superannuation Fund (SMSF) operating in Australia, although members can contribute to public funds in Australia as well. Under the SMSF model, individuals may voluntarily set up a superannuation trust fund to

⁵² IMF (2010), note 19.

⁵³ Koh, S, Mitchell, S and Fong, HY (2010) *Collective Investments for Pension Savings: Lessons from Singapore's Central Provident Fund Scheme*. USA: University of Pennsylvania Press.

⁵⁴ Mahmud, W (2003) 'Bangladesh: Development Outcomes and Challenges in the Context of Globalization', World Bank Conference, Yale University, 10-11 October, <<http://www.ycsg.yale.edu/activities/files/Wahid.doc>>.

⁵⁵ Miyan, Alimullah M (2005) 'Retirement and Pension System in Bangladesh' 3(2) *International Society for Labour and Social Security Law* 11.

provide for themselves and their beneficiaries. Applying the modern portfolio theory, each SMSF boosts the expected rate of return on investment by prudentially taking on more risk. In practice, this allows for timely and annual investment options with the objective of higher rates of return.⁵⁶

When we contrast this activity with the Bangladeshi pension and provident funds system, no like model or structure can be found. Consequently, individuals are not afforded the opportunity to engage in or control their own investments through a suitable prudential trust framework. Economically, the Bangladeshi people do not have incomes comparable to those living in affluent nations, and to encourage individuals to take advantage of a third pillar structure if it were available, it will be necessary to target groups of suitable contributors in a national mutual funds savings scheme.

A fiscal review is conducted every five years by the WB and the IMF, who usually have extensive, ongoing discussions on Bangladeshi pension issues, concentrating particularly on the fiscal framework.⁵⁷ They suggested reforming the infrastructural investment and social spending program, and also prioritising the reform of prudential regulations for the banking, pension and insurance sectors.⁵⁸ Bangladesh has a non-independent government administrator of the public sector pension fund system. This is also true of the private pension fund system, which is also subject to regulatory compliance obligations.

Generally, however, pension and provident funds are subject to the legal compliance required of a trust fund. As the situation in Bangladesh involves a non-independent trust framework should the issue of mistrust arise as was illustrated in the pivotal case involving Native American Indians and the US federal government, where the notion of fiduciary duty was explored and the government held to account, it is imperative that the administration be separated from total government control to one of combined inter-dependence.⁵⁹

⁵⁶ Nicoll, G (2006), Note 39.

⁵⁷ IMF (International Monetary Fund) (1995), note 23.

⁵⁸ Financial Sector Assessment Program (FSAP) (2009) 'Program for Financial Assessment of Bangladesh' IMF and World Bank. 25 January <www.imf.org>.

⁵⁹ Nicoll, G (1997) 'New Age Corporate Governance' 8 *Australian Journal of Corporate Law* 105.

Referring to the *Cobell* case,⁶⁰ we see that it is expedient for the pension fund that the trustee must be an independent legal entity, so as to safeguard pension fund members having a legal or beneficial right or some other contractual claim against the assets of the pension fund. For example, a combined inter-dependent trust fund prudential committee may be formed comprising both government and private members who are responsible for deciding the investment allocation and redistribution of benefits. Once established, confidence in the management and its prudential activities ought to grow as awareness increases concerning the decentralisation of the pension and provident fund system. Government continues to play its role by being instrumental in legislating, regulating and supervising financial institutions and fund managers. In giving effect to these changes, the principles of international corporate governance in the pension and provident fund will then be clearly seen by the pension fund contributors themselves.

Effective change may be brought about by subscribing to the guidelines for the establishment of pension fund entities and the operation of funds within a regulatory and supervisory framework have been provided by the IOPS. Exposition of principles provided by IOPS relate to terms requiring the fund to treat all beneficiaries equally as members, similarly to Australia where superannuation funds are mostly free of tax at the point of contribution on investment income, and at the time benefits are received by the beneficiary.⁶¹

In conclusion, taken together the ADB, WB, IMF and IOPS have hopes for Bangladesh. At present, the principles of the three-pillar pension system are not fully implemented in the pension and provident fund management structure in Bangladesh. However, a thin layer of the first pillar can be seen in the public sector but is entirely lacking in the private sector. Both the second and third pillars are not evident in any part of the public or private sector. Without dismissing any of the pillars, the author argues that at least the second and third pillars be immediately implemented so that a universal pension fund can be built and developed in Bangladesh.

⁶⁰ *Cobell v Salazar* (reported, DC of USA, Lamberth CJ, Mark J, Civ/ Appeal No. 96-1285 RCL, 10 June 1996), retrieved from www.indiantrust.com/index.cfm.

⁶¹ IOPS (2006) 'Principles of Private Pension Supervision', International Organization of Pension Supervisors, Istanbul: Turkey.

2.5.3 SUGGESTIONS BY THE INTERNATIONAL MONETARY FUND (IMF)

The WB and IMF have had extensive, ongoing discussions on pension issues, particularly concentrating on the fiscal framework.⁶² They have also directly participated in assessing the Bangladeshi financial sector, suggesting a reform of the infrastructural investment and social spending program. They also prioritised the reform of prudential regulations for banking, the pension and the insurance sector,⁶³ and guidelines were provided by the IOPS to establish pension funds.

2.5.4 GUIDELINES OF THE INTERNATIONAL ORGANISATION OF PENSION SUPERVISORS (IOPS)

The OECD and the IOPS provide guidelines for the establishment of pension fund entities and the operation of funds within a regulatory and supervisory framework.⁶⁴ The terms of the fund must treat all beneficiaries equally as members. The pension entity should be an independent legal entity with the legal capacity and legal responsibility for the pension fund. The authorised pension entity should have the right to a taxation benefit. For example, in Australia, private pensions known as superannuation funds are mostly tax-free at the point of contribution to a fund, on investment income, and at the time benefits are received.⁶⁵

The pension fund trustee may be an independent legal entity. Additionally, an insurance company or other financial institutions may play this role. Pension fund members should have a legal or beneficial right or some other contractual claim against the assets of the pension fund. It may be either a trust or an independent entity with legal capacity.⁶⁶ However, the fund management company may manage the pension funds. There should be a pension plan and according to this plan, the benefits cannot be paid at all or without a significant penalty or reason. It might be a part of a broader employment contract. To act in the exclusive interest of the pension members

⁶² IMF (1995), note 23.

⁶³ Financial Sector Assessment Program (FSAP) (2009) 'Program for Financial Assessment of Bangladesh' IMF and World Bank. 25 January <<http://www.imf.org>>.

⁶⁴ The OECD has adopted the guideline to provide directions to the licensing of pension entities, especially for private pensions. This guideline is monitored by the International Organisation of Pension Supervisors (IOPS).

⁶⁵ IOPS (2006) 'Principles of Private Pension Supervision', International Organization of Pension Supervisors, Istanbul: Turkey.

⁶⁶ IOPS (2006), note 60.

and other beneficiaries a corporate trustee may be established. The activity should be maintained by the regulatory and supervisory authority.⁶⁷

This guideline indicates an effective supervisory and regulatory pension management system which is vital to promote and develop the pension market. It does have effective impartial and procedural requirements in that it comprises the regulatory and supervisory bodies which are consistent with the pension system, policies and procedures. It ensures a systematic treatment of the plan members as provided under the terms of the plan and consistent with the pension laws of the country. Therefore, the guidelines indicate a continuous supervision of the regulatory tools and pension plans that support the pension entities to meet the minimum criteria from the point at which they are entitled to accumulate funds.⁶⁸ In practice, this guideline is useful for occupational, private and publicly managed pension entities. It might be used for personal pension plans as well because it identifies the risk control mechanism and notion of governance.

2.6 INTERNATIONAL STANDARDS FOR THE DEVELOPMENT OF PENSION FUNDS

The following discussion will consider how the pension funds standards of the developing countries have been influenced by the WB, ADB, IOPS and IMF. The WB has suggested the standards for countries lacking a strong financial sector be encouraged to adopt the three-pillar approach by implementing one pillar at a time. In addition, the IOPS and the ADB have placed emphasis on nascent trust institutions to invest the provident and pension funds according to the three-pillar system.

2.6.1 INTERNATIONAL STANDARDS FOR PENSION FUND SYSTEMS IN DEVELOPING COUNTRIES

In the global financial market, issues involving the legal foundations and administration of pension funds are becoming very important. Pension funds in both the public and private sectors are now the predominant contributors to national savings and international financial markets. Most countries in the Asia-Pacific region are struggling to improve their economic and social

⁶⁷ OECD (2004) 'Funded Pension Schemes for Government Workers: Proposal for Study', Manila Conference, OECD No. 4: 30 March <www.oecd.org>.

⁶⁸ IOPS (2006), note 60.

circumstances through pension and provident funds at the national and international levels. They have begun to rethink their pension funds agenda with the encouragement and assistance of the ADB.

The WB, the IMF and the ADB have expressed their interest in reforming the Bangladeshi provident and pension funds system since 1992.⁶⁹ To date, Bangladesh has been unable to satisfy the standards of the WB's Second and Third Pillars of the Pension System.⁷⁰ This standard includes the progressive liberalisation or deregulation of the pension sector and the effective strengthening of the regulatory and supervisory functions of the concerned ministries.

2.6.2 THE ASIAN DEVELOPMENT BANK APPROACH

In its most recent report on the establishment of the pension fund in Bangladesh, the ADB concluded that there were considerable difficulties for establishing the fund. In particular, the ADB concluded: 'The insurance and pension/provident fund sectors were in a nascent stage of development with a weak regulatory and operational framework.'⁷¹ The Department of Insurance under the MOC as a regulator of the insurance industry is institutionally very weak due to severe shortage of qualified staff, poor leadership, deficiencies in organisation, policies and procedures, and inadequate support from MOC and the government.⁷²

In the public sector, the government operated a compulsory Government Pension Scheme (GPS) and CPF. In the private sector, pension schemes, provident funds, and gratuity schemes which have been established as trust funds require the NBR's approval for tax deduction and incentives under *Income Tax Ordinance, 1995*. Prior to 1995, neither the public nor private sector schemes were active participants in the capital market due to restrictions limiting their investments to government and government-approved securities. 'There is a lack of experienced investment

⁶⁹ Auwera, Vander M (2006) 'Pension Reform and ADB Interventions', Discussion Paper No, 010907. Manila, Philippines: Asian Development Bank, 23 December <www.adb.org>.

⁷⁰ TA (1993-2000) 'Perform of Pension and Provident Funds in Selected Developing Member Countries', Technical Assistance Performance Audit Report, Asian Development Bank, 12 August <www.adb.org>.

⁷¹ TA 2915-BAN (1997), Note 42.

⁷² TA 2915-BAN (1997) 'Insurance and Pension and Provident Fund Reforms of Bangladesh', Technical Assistance Completion Report, Asian Development Bank, 14 July <<http://www.worldbank.org>>.

managers'.⁷³ Additionally, significant failures have occurred in insurance and trust law and regulation for investment. In this regard, Bangladesh has been advised by various international banks on the financing of pension funds, and these banks have been actively interested in the reconstruction and development of pension and provident funds systems.

2.6.3 THE WORLD BANK'S 'MULTI-PILLAR' APPROACH

The WB is an acknowledged leader in assisting countries to ensure that their pension systems are adequate, affordable, sustainable and robust.⁷⁴ In the 1990s, it took a leading role in pension fund reform by proposing a very specific definition of a multi-pillar pension scheme. The scheme 'ideally' mandated an unfunded DB pension system, which is publicly managed and responsible for the objective of alleviating poverty. Additionally, the scheme includes a DC pension system, which is privately managed with the objective of income replacement. Finally, the scheme comprises voluntary and funded retirement provisions to compensate any perceived retirement income gap for individuals, especially at the higher income end.

Although the 'ideals' of the scheme are sound, unfortunately the existing pension and provident funds system of Bangladesh has become a source of macroeconomic instability, a constraint upon economic growth, and an ineffective and/or inequitable provider of retirement income due to the non-implementation of the 'multi-pillar' approach.⁷⁵ Currently the government of Bangladesh provides some financial benefits to the poor and socially disadvantaged groups but does not provide a universally social safety network, which the author argues should be established as a universally accessible pension fund aligned with the scheme's 'ideals'.

The WB's strategy for pension reform is formalised in its report titled *Social Protection Sector Strategy: From Safety Net to Springboard*.⁷⁶ This report describes a multi-pillar framework consisting of a publicly managed tax-financed pension system, privately managed funded scheme and voluntary retirement savings. The WB's report followed up on its earlier policy research report, *Averting the old age crisis: policies to protect the old and promote growth* (1994), which

⁷³TA 2915-BAN (1997), note 68.

⁷⁴Holzmann, R (2000), note 6.

⁷⁵Hassan, M (2007), note 44.

⁷⁶World Bank (2001) 'Annual Report (Year in Review)' International Auditing Department, WB Group: Washington, D.C., 5 August <<http://publications.worldbank.org/ecommerce/>>.

offered a more detailed and prescriptive exposition of a multi-pillar pension framework. This 1994 report gained prominence worldwide as favouring funding by the WB and the ADB, and for underpinning financial assistance provided by the WB to countries during the period 1984-2004. The WB supported a wide variety of pension reforms through analytical and advisory services and lending operations.

The WB's strategy for a multi-pillar pension system such as that referred to above relies on ensuring that sound macroeconomic policies and an adequate financial sector are in place. In countries where initial multi-pillar conditions do not exist, the WB generally supports pay-as-you-go (PAYG) reforms that, in turn, contribute to fiscal objectives.⁷⁷ Nonetheless, in a number of instances, the WB has supported multi-pillar reforms even though there were clear weaknesses in the country's underlying economic and financial structure.⁷⁸ Low-income countries with negative savings rates may prefer a PAYG pension system because their governments can easily pay the pension benefits from the country's current revenues. It is confirmed that most PAYG-type pension systems fail to provide an adequate level of old-age income assistance and are financially unsustainable.⁷⁹

The WB's strategy for pension reform is to support a multi-pillar framework as best practice if proper initial conditions are in place. These include sound macroeconomic policies, an adequate financial sector, and a capacity to implement them. If these conditions are not met, the World Bank aims to improve the system through other means to create fiscal stability and protection of the aged.⁸⁰ The WB has largely supported a flexible, multi-pillar pension framework, consistent with its strategy.⁸¹ The 80% ratings for the WB's assistance to those countries engaged in pension reform have been satisfactory. The World Bank's success in strengthening multi-pillar regulations has been generally concerned Europe and Central Asia.⁸² The multi-pillar framework consists of a publicly unfunded pillar, a privately funded pillar, and a voluntary pillar. Both the PAYG and multi-pillar pension systems are supported by the WB in that they consist of a five-

⁷⁷ World Bank (2006), note 12.

⁷⁸ World Bank (2006), note 12.

⁷⁹ Holzmann, R and Hinz, R (2005) 'Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform', Washington, D.C.: World Bank, 23 February <<http://www.info.worldbank.org>>.

⁸⁰ ⁸⁰ World Bank (2006), note 12.

⁸¹ World Bank (2006), note 12.

⁸² Khasanbaev, A and Pfau, W.D (2009) 'The Funded Pension Scheme in Uzbekistan: An Analysis' 31(1) *Sophia International Review* 75.

pillar framework. The WB has not provided detailed guidelines to assess the priority and need for multi-pillar pension reform. In South Asia, credits to India were provided to improve actuarial forecasting and reduce liabilities in the pension fund.⁸³

Several years ago the WB proposed a very specific definition of a multi-pillar or three pillar pension schemes. Its three-pillar model can serve as a useful construct to illustrate how the different approaches fit together to serve different policy goals or functions. The three-pillar model separates the major objectives of social security into three pillars, each with its own source of funding. The first pillar provides social safety net support to everyone, the second pillar emphasises savings and promotion of growth, and the third pillar encourages discretionary savings and capital development.⁸⁴

The first pillar addresses redistribution and social safety net issues directly, and provides basic support for everyone. This pillar would be publicly managed and funded from general revenues, in part because even those who prefer an enlarged role for the private sector in pensions recognise that redistribution is best achieved through government intervention.

Many countries have extended Pillar I well beyond this basic re-distributive function of having it also provide a significant portion of retirement income even for the non-poor. While many analysts argue that this has served retirees well, there are problems with extending Pillar I past the basic re-distributive and poverty alleviating function. These include high contribution rates, tax evasion, and labour market distortions. One of the most innovative recent developments to avoid those distortions is Pillar I mimicking Pillar II in the form of so-called “notional defined contributions”.⁸⁵ Such a pillar exists in Sweden, Poland and Latvia and it is based on having a PAYG pension system with strict proportionality between contributions and benefits and with benefits varying based on changing life expectancies.

The second pillar should be mandatory for several reasons. Privately managing the second pillar also has advantages. First, competitively managed pension funds are more likely to focus on maximising investment returns and reducing risk for shareholders, who are the owners of

⁸³ World Bank (2006), note 12.

⁸⁴ Rutkowski, M ‘Key issue in debates on modern pension system’ discussion paper presented in the World Bank Conference for Pension Reform in Poland (1996-97).

⁸⁵ Queisser, M and Vittas, D (2000) ‘The Swiss Multi-pillar Pension System: Triumph of Common Sense?’, Development Research Group, World Bank, 20 August <www.thinkswiss.org>.

retirement plans. Publicly managed funds, especially those in developing countries, are vulnerable to political pressures to invest in poorly performing state enterprises or to provide an easy source of capital for government projects. Second, private management of pension funds can foster the development of a country's financial markets by creating demand for financial products and institutions. Both of these advantages are also possible in a publicly managed system, provided that fund managers invested contributions in the capital markets. Although private sector competitive management provides incentives for good performance, extensive government regulation and supervision is vital to compensate for market failures such as lack of information by workers and socially inefficient restrictions imposed by employers. Second pillars now exist in many countries such as Chile, Argentina, Hungary and Poland.

The second pillar would provide retirement income above the poverty floor up to a level that society feels is necessary so that the elderly will not be a burden due to lack of income. Unlike the public pillar – which is redistributive, centrally controlled, and tax-financed – the second mandatory pillar should emphasise savings. It should therefore be non-redistributory and fully funded, with decentralised control over the accumulated pension and savings reserves. It could be based on occupational schemes, personal accounts, or a combination of both.

The third pillar in almost all variations of this model is voluntary, fully funded, and privately managed. A voluntary, privately managed pension fund will allow any citizen to make deposits for her or his future, whether poor or rich both can contribute a portion based on the amount of derived income they each receive. For the poor, to help them with their initial start-up of the fund, the government could provide a small contribution. Encouragement of both individuals and businesses to save for more generous benefits as a worthwhile goal, is the role of the third pillar. The practical value of that form of encouragement is realised when the benefit of tax advantages are given back to the people.⁸⁶ However, in providing even small contributions to help the poor commence a pension fund, where the national budget of Bangladesh depends heavily on external aid, there may not be a sufficiently stable revenue base to support the implementation of the third pillar of the multi-pillar system.⁸⁷

⁸⁶ Michael Rutkowski, (1997) *Key Issues in Debates on Modern Pension Systems*, The World Bank, Washington, D.C.

⁸⁷ The World Bank (2006), note 12.

2.6.4 THE ASIAN DEVELOPMENT BANK'S CONCERN FOR BANGLADESHI CONDITIONS

Compared to the multi-pillar system, the ADB plays an active role in assisting pension reform programs in the Asia-Pacific region. Generally, the ADB advocates a multi-pillar pension system in which the fund is mostly funded. It is the most suitable structure to deal with these challenges. This structure, however, remains a theoretical framework that needs to be adjusted to local conditions.

Under this approach, there may be greater focus on objectives and reform criteria than on the structure of a multi-pillar system. Given that the primary objective of a pension system is to deliver adequate and affordable benefits in a sustainable way, the legal constitution of the fund and its administrative processes should specify clearly the benefits that the fund will pay to members. This is very important if the fund is to provide effectively for the majority of the population and reduce poverty among the most vulnerable elderly citizens. The pension fund system should be affordable for both individuals and government, and not interfere with other more pressing needs or have untenable fiscal consequences. The pension fund system should also be sustainable and financially sound, now and in the future.⁸⁸ In the past, the ADB approached pension reform primarily from a financial perspective, but a more recent ADB report from its independent evaluation department suggests that the ADB may now be revisiting its underlying assumptions for social policy. The WB and the ADB have provided technical assistance to effect pension reform to India. In 1999, the ADB approved a USD\$ 1 million credit line to India to improve its private and public provident fund systems and its Employees' Provident Fund Organisation. In 2003 and 2004, the ADB approved a further USD\$ 1.75 million dollar credit line to India to reform its pension fund for the unrecognised types of employment in the private sector of different states.⁸⁹ This demonstrates that the ADB understands that pension reform in developing countries will help develop capital markets, which will further deepen and broaden the options for industrial sector and augment economic development.

⁸⁸ Roundtable Report (2004) 'Asian Pension Fund', October 25-26 Tokyo, Japan: Pacific Pension Institute and Asia Foundation.

⁸⁹ TA 3367-IND (1999) 'Indian Pension Reformation', Technical Assistance Performance Audit Report, Asian Development Bank, 24 April <<http://www.adb.org>>. TA 4226-IND (2003) 'Reform of Pension and Provident funds of India', Technical Assistance Completion Report, Asian Development Bank, 21 April <<http://www.adb.org>>. TA 4548-IND (2004) 'Indian Pension and Provident Funds', Technical Assistance Performance Audit Report, Asian Development Bank, 5 April <<http://www.adb.org>>.

2.7 CONCLUSION

The need for a sustainable and universal pension fund in Bangladesh stems from the literature on economic and social justice. For nearly 40 years the established economic literature has identified a role for pensions in reinforcing the social welfare net, social security and greater economic equality. Bangladesh also needs this pension fund in fortifying capital markets for investment in the domestic and international markets. The reality is that Bangladesh is a country where poverty levels and social inequality are particularly high. It is therefore important for Bangladesh that it encourages the growth of a middle class that can save for investment. Furthermore as far as global markets are concerned, pension funds are very important for marshalling national savings most effectively.

The WB, ADB, IMF, OECD and IOPS have identified these needs and benefits in different ways. The common thread in these organisations' reports is that they all see the need for the pension fund and its role in breaking Bangladesh's poverty cycle. While they each see the value expressed in different terms in developing the economic model of Bangladesh, there are significant difficulties in establishing the pension fund. These difficulties are examined in the following chapters.

CHAPTER 3: IDENTIFIED FAILINGS IN BANGLADESH REPORTED BY THE ASIAN DEVELOPMENT BANK

3.1 INTRODUCTION

This chapter examines the specific findings of the reports of the WB and the ADB. Here, the author analyses the findings of the WB and the ADB, identifying the deficiencies referred to by these reports. Some of the most important are: firstly, weaknesses within the MOC;⁹⁰ secondly, weaknesses of pension funds and insurance companies because they are nascent financial institutions in Bangladesh;⁹¹ thirdly, regulatory weaknesses;⁹² and fourthly, corporate governance weaknesses.⁹³

Having identified these weaknesses, the author concludes that failures seen by the ADB within the MOC are failures of administration that have long been difficulties for countries such as Bangladesh as well as India and Pakistan. The author's approach in Chapter 5 is to consider these issues comparatively, examining the way in which India, for example, is addressing these problems as it re-shapes its pension fund framework. He also concludes that the last three weaknesses identified by the ADB are inter-related. For this reason, the author argues in the remainder of the thesis that pension funds and nascent institutions are essentially restricted in their development because the provident fund itself is not universally accessible to all employees. The remaining chapters of the thesis seek to develop this idea. Importantly, the development of independent universally accessible funds and related institutions will rest heavily on the use of the trust concept (see Chapter 6). The continuing operation of these funds, and public confidence in their operations, will depend on an effective legal and regulatory system (see Chapter 7).

⁹⁰ Asian Development Bank (ADB) (1993) 'Reformation of Pension and Provident Funds of Bangladesh', Asian Development Bank's Report, Technical Assistant Documents Database, World Bank, 10 September <<http://www.worldbank.org>>.

⁹¹ Asian Development Bank, 'Technical Assistance Loan: Improvement of Capital Market and Insurance Governance Project (Bangladesh)', Project No. BAN 36197, March 2008. <<http://www.adb.org/documents/pams/ban/36197-ban-pam>>.

⁹² Asian Development Bank, 'Technical Assistance to Bangladesh for Preparing the Pension and Insurance Sector Project', January 2001. <<http://www.adb.org/documents/tars/ban/r12-01>>.

⁹³ Asian Development Bank (ADB) (1997), note 4.

3.2 WORLD BANK AND ASIAN DEVELOPMENT BANK'S AID TO BANGLADESH

The WB and the ADB have been interested in reforming the Bangladeshi Provident and pension fund system since 1992. Previously, the government had a compulsory GPS and CPF. The private pension scheme, provident fund, and gratuity scheme established as trust funds had to be approved by the NBR for tax deduction and incentives under the *Income Tax Ordinance, 1995*. Both sectors were not active participants in the capital market because of restrictions limiting their investments to government and government-approved securities and lack of experienced investment managers.⁹⁴ These represented significant failures in law and regulation. The ADB has suggested that the development and necessary reform of the insurance and pension sectors will help the Bangladeshi capital market to accumulate national savings for investment, which may represent a progressive source of obtaining a good return for fund members.

The ADB and WB have provided technical assistance to realise pension reform in India as well. The ADB approved a one million dollar credit line to India in 1999 to improve its private and public provident fund system and Employees' Provident Fund Organisation. With these strategies India is gradually improving its pension fund system.

3.2.1 ADB REPORT – WEAKNESSES IN ADMINISTRATION AND REGULATION

In Bangladesh, most insurance companies do business by recruiting marketing agents. Most of these agents are not properly trained or educated in convincing people that they should commence an insurance policy. They do not know how to engage people so that they become policy holders.⁹⁵ The ADB encountered this widespread problem in its research.

The ADB, in concluding that there were considerable difficulties in establishing the pension fund in Bangladesh, stated that:

The insurance and pension/provident fund sectors were in a nascent stage of development with a weak regulatory and operational framework. Department of Insurance (DOI) under the MOC, as a regulator of the insurance industry, was institutionally very weak due to severe

⁹⁴ The ADB Technical Assistance Completion Report, TA 2915-BAN: Insurance and Pension and Provident Fund Reforms, approved date 20 Nov 1997, Completion date Aug 1999, Division: SAGF, Executing Agency: Ministry of Commerce.

⁹⁵ Annual Report 2004, 'Principles and Practices of Bangladesh Insurance', Insurance Journal, Book Mart Publishers, Dhaka.

shortage of qualified staff, poor leadership, deficiencies in organization, policies and procedures, and inadequate support from MOC and the Government.⁹⁶

Although Bangladesh did receive 1.7 million USD during 1993-1997 to reform its Insurance Industry, Pension and Provident Funds operations,⁹⁷ by 2000 (PPTA 3590 BAN)) the project which had provided preparatory technical assistance to the Insurance and Pension Funds Development of Bangladesh was cancelled due to lack of progress.⁹⁸ Furthermore the ADB provided technical support to Bangladesh in asset securitisation with institutional good governance to reduce poverty.⁹⁹ Some legal and technical difficulties were identified by the WB and the ADB. For example, the pension obligations of the government are not fully funded and the *Trusts Act, 1882* prohibits funds from being invested fully in equities, corporate debentures and private money market instruments.

Other common weaknesses in Bangladesh arise due to poor administration and governance. It was to clarify these weaknesses that the author undertook his empirical research (Appendix A). In Bangladesh the pension fund management disclosure requirements are unclear. Beside this there is insufficient publicly available information that addresses Bangladesh's pension fund compliance. The Bangladeshi pension system is massively corrupt.¹⁰⁰ Pension seekers have to process eight to sixteen types of documents and spend 159 days trying to get their pension. The Bangladeshi pension system is prey to petty pension laws, rules and regulations, poor record management, and procedural complexity.¹⁰¹ Since 1997 the ADB has found that the pension, provident and insurance industries in Bangladesh are underdeveloped and poorly regulated. The ADB's 2001, 2006 and 2008 reports¹⁰² drew attention to the fact that the legal frameworks of the pension and insurance industries are extremely weak and actually damage participants' ability to

⁹⁶ TA 2915-BAN (1997), note 4.

⁹⁷ (ADTA project TA 1993BAN 1993 & TA2915-BAN 1997) <<http://www.worldbank.org>>.

⁹⁸ ADB Technical Assistance Documents Database. <<http://www.worldbank.org>>.

⁹⁹ Discussion Paper 'Strengthening the Criminal Justice System' Asian Development Bank. This paper submitted to the ADB Regional Workshop in Dhaka, Bangladesh, 30-31 May 2006. At this workshop the ADB's General Counsel Mr Arthur Mitchell mentioned that the ADB had been actively supporting law and policy reforms in Bangladesh - a developing member country of the ADB.

¹⁰⁰ Staff Correspondent (2008) 'Pay Bribe, Get Pension' *The Daily Star*, 26 August, 1. <<http://www.bangladeshnews.com.bd>>.

¹⁰¹ OECD (Organisation for Economic Cooperation and Development) (1994) 'Bangladeshi Pension System', World Bank Conference, OECD, 9 November <<http://www.oecd.org>>.

¹⁰² Asian Development Bank (2001) 'Technical Assistance Loan: Improvement of Capital Market and Insurance Governance Project (Bangladesh)', BAN36197, Manila, 23 July <<http://www.adb.org/documents/pams/ban/36197-ban-pam>>.

mobilise long-term savings.¹⁰³ An analytical report in 2003 noted that the WB and the ADB studies advised Bangladesh to adopt international principles of corporate governance and legal framework for developing these sectors. The ADB approved a USD 3 million loan to Bangladesh for legal infrastructure development and corporate governance in these sectors.¹⁰⁴ The pension and provident funds in Bangladesh operate within a weak regulatory and operational framework. For example the GPS, the Provident Fund (PF) and the Gratuity Schemes have not introduced yet as a trust funds. The supervisory structure is not clearly understood by the average public and private servant. The new investment rules have not yet been established.¹⁰⁵

The insurance industry sector has not yet come forward to manage the risk of funds investment. The capital market is losing the opportunities to introduce regulatory best practices, prudential norms, and monitoring and surveillance systems. Taxation, liquidity of investment alternatives do not exist in the current money market of Bangladesh. The Bangladesh Service Rules do not allow the employers to regulate the investment procedures of Pension and Provident Funds for employees.¹⁰⁶

Bangladesh has not yet formulated policies/laws for providing pension and retirement benefits for workers in agriculture and industry, such as garments workers who will need to survive economically in their old age. Such laws should be implemented, starting with the recognised public and private sectors. Bangladeshi workers who are employed abroad and contribute to the economic development of their country through their remittances should be granted pensions on their repatriation. This will enable them to reintegrate into mainstream Bangladeshi society. It means in effect creating a retirement benefit fund for migrant workers.

3.2.2 WEAKNESSES IN NASCENT INSTITUTIONS

The government's National Poverty Reduction Strategy of Bangladesh (NPRS) identifies weaknesses in financial institutions and the capital market in raising funds for investment. These

¹⁰³ Asian Development Bank (2001) 'Technical Assistance to Bangladesh for Preparing the Pension and Insurance Sector Project', January 2001, <<http://www.adb.org/documents/tars/ban/r12-01>>.

¹⁰⁴ Sobhan, F and Werner, W (2003), 'A Comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh', Dhaka: Bangladesh Enterprise Institute. <<http://www.bei-bd.org/documents/cg%201>>.

¹⁰⁵ Lahiri, A (2003) 'The Significance and Socio-economic Rationale of Recent Pension Reform Initiatives', Paper presented at the International Conference on Social Security Policy: Challenges before India and South Asia, 4 December, New Delhi.

¹⁰⁶ Rule 337, Bangladesh Service Rules 1947, Bangladesh Government Press, Tejgaon, Dhaka 1883.

weaknesses are associated with poor governance, ineffective monitoring, lack of supervision, and non-enforcement of regulations by a competent regulatory authority, inadequate regulatory and institutional infrastructure, and lack of diversification of investment products and services. The NPRS also states that financial and regulatory reformation must be maintained to meet the growing demand for the country's economic stability.¹⁰⁷ It has also suggested enhancing the capacity of people who work in the stock exchange, insurance industry and other financial sectors to improve the governance and management of finance markets in Bangladesh. In that respect the NPRS recommended staff training, reviewing regulations and adopting the International Organization of Securities Commission (IOSCO) standards and principles.¹⁰⁸ The ADB made a similar recommendation in its completed report on technical assistance titled *Capacity Building of the Securities and Exchange Commission and Selected Capital Market Institutions*. It reported that the staff training on legal aspects of corporate governance, transactions in securities and management, and investment of funds in the capital market need to be revised.¹⁰⁹

The stock market crashes of 1996 and 2011 were evident that the Bangladesh stock exchange lacked prudential regulatory support, effective government policy and the confidence of general investors.¹¹⁰ Many small investors experienced grave financial losses during these share market crashes. The Probe Committee, commenting on recent manipulation of the share market, found weaknesses in relation to moral and professional failures that actually hindered the full administration of the capital market of Bangladesh.¹¹¹ The committee chiefly recommended to the government to reorganise and demutualise the Securities and Exchange Commission (SEC).¹¹² The author argues that an independent trust administration and a separate regulatory

¹⁰⁷ National Strategy for Poverty Reduction Report (2004), 'Poverty reduction: Unlocking the potential', General Economics Division, Planning Commission, Government of Bangladesh, Dhaka.

¹⁰⁸ IOSCO, as the principal international securities regulatory standards-setting organisation, advocates the integrity of capital markets as essential to a country's financial stability and economic prosperity. It provides guidelines so that regulators can identify and address possible weaknesses in a financial system.

¹⁰⁹ T.A. No. 3533-BAN (2002), 'Funding Agency: ADB (from Japan Special Fund)', Executing Agency: Securities and Exchange Commission of Bangladesh.

¹¹⁰ Sohail, T (2011) 'Power, Rumours and Stock Market Crash,' *The Financial Express*, Vol. 18, No. 137, Monday March 28, Dhaka

¹¹¹ Sohail, T (2011), Note 110.

¹¹² Byron, R. K and Rahman, F (2011), 'Overhaul share regulator: Probe body offers over 30 recommendation', *The Daily Star*, Front page, April 8, Dhaka, <<http://www.thedailystar.net/news>>.

framework are vital if corporate governance in nascent institutions, including the SEC, is to be properly developed.

In Bangladesh, there are more than three dozen mutual funds listed on the two stock exchanges market. The mutual funds in Bangladesh are one of the strongest vehicles for growing the stock markets, and very active in marshalling national savings. The future prospect of mutual funds will depend on professional management, innovation and the quality of mutual funds, including amendments to the SEC's *Mutual Fund Rules 2001*.¹¹³ The prosperity of mutual funds depends particularly on SEC behaviour, including administrative and enforcement practices from an institutional perspective.¹¹⁴ Bangladeshi mutual funds are currently using only 3% of total capitalisation in the market. On the other hand, India is investing more than 40% of Gross Domestic Product (GDP) towards total capitalisation of its mutual funds due to the recent development of the corporate trustee framework.¹¹⁵ Recently the SEC granted a large mutual fund under the title 'Bangladesh Fund'.¹¹⁶ To make mutual funds more operative and profitable, nascent institutions need to be developed in Bangladesh.¹¹⁷ India has already set up this process, progressively establishing a separate and independent administration working within a corporate trustee framework. In place of government control, the Securities and Exchange Board of India (SEBI) functions as a statutory and autonomous regulatory board with defined responsibilities, undertaking both development and regulatory work for the market.¹¹⁸ This process is also now happening in Pakistan.¹¹⁹

3.2.3 INSURANCE INDUSTRY

¹¹³ Byron, R. K and Rahman, F (2011), 'Overhaul share regulator: Probe body offers over 30 recommendation', *The Daily Star*, Front page, April 8, Dhaka, <<http://www.thedailystar.net/news>>.

¹¹⁴ Donald C. Langevoort (2008), note 3.

¹¹⁵ Shoikot's blog, 'Mutual fund deluge this year' April 4, 2009. This is a very popular blog on the Dhaka and Chittagong Stock Exchanges. <<http://www.shoikotsblog.blogspot.com>>.

¹¹⁶ Ali, A (2011), 'Bangladesh Fund permitted to collect funds', *The Daily Amadershomoy*, August 18, Front page, Dhaka. <<http://www.amadershomoy.com>>.

¹¹⁷ Staff Correspondent (2011), 'TK 5,000cr Bangladesh Fund Okayed', *The Daily New Age*, August 18, Front page, Dhaka. <<http://www.newagebd.com/newspaper>>.

¹¹⁸ Securities and Exchange Board of India, Basic objectives, Regulator roles and Investment policy <<http://www.finance.indiabizclub.com>>.

¹¹⁹ Byron, R. K and Rahman, F (2011), Note 111.

The ADB has concluded that the insurance industry in Bangladesh is weak and ineffective in supporting the pension or provident fund.¹²⁰ The government nationalised the insurance industry via the *Presidential Order*, 1972. It was later denationalised by mid-1980. There are 62 insurance companies operating in Bangladesh, including 59 private, 2 state-owned and 1 foreign-owned insurance companies. Of these insurance companies, 18 are life insurance companies and 44 are non-life insurance companies. In Bangladesh, these insurance companies usually offer products such as life insurance, health insurance, agricultural insurance, livestock insurance, crop insurance, property and asset insurance. However, social insurance in the form of pension insurance is not offered. The insurance companies of India and benchmark countries of Australia and Singapore offer these types of social annuities for pensioner.¹²¹ As a consequence, there is no sufficient regulation of the insurance industry to operate pension funds in Bangladesh.

Since 1998, the ADB undertook several research projects on the Bangladeshi insurance industry.¹²² The ADB concluded that the insurance sector was underdeveloped and poorly regulated.¹²³ In 2007, the ADB provided to Bangladesh a technical assistance loan for improving the original 1938 insurance legislation,¹²⁴ by instituting corporate governance and establishing a new and autonomous regulatory authority. In 2008, an independent Insurance Regulatory Authority (IRA) was established to regulate, monitor and supervise public and private insurance companies under the Insurance Regulatory Authority Ordinance and the Insurance Ordinance of 2008. Prior to the creation of the IRA, the Controller of the Insurance (The Insurance Directorate) operated under the jurisdiction of the MOC. Now the Insurance Regulatory Authority is part of the Ministry of Finance and regulates the insurance industry of Bangladesh. The Insurance Regulatory Authority is a statutory body responsible for ensuring consumer protection, licensing, policy approval, monitoring and investigations. It consists of 5 members headed by the Chairman and all members are appointed by the government.

¹²⁰ Asian Development Bank (2001), Note 102.

¹²¹ Joelle H.Y. Fong, Olivia S. Mitchell, and Benedict S. K. Koh (2010), *Longevity Risk Management in Singapore's National Pension System*, PRC WP2010-10, Pension Research Council Working Paper, Pension Research Council, The Wharton School, University of Pennsylvania.

¹²² Asian Development Bank (1998), 'Country Operational Strategy Studies: Bangladesh,' Manila conference <<http://www.adb.org>>.

¹²³ Standard Report of Insurance Core Principles prepared by the Financial Standards Foundation. This paper has been submitted to the meeting on Financial Infrastructure Development for D-8 Countries in Cairo, Egypt on 4-5 October 2009. <<http://www.estandardsforum.org>>.

¹²⁴ The caretaker military government of Bangladesh proclaimed the Ordinance in 2008 which repealed the 1938 Insurance Act (as amended in 1993).

The author appreciates the formation of a separate insurance authority, yet still argues that the administration should be independent of government control. The establishment of corporate governance practices must be achieved without any undue political influence. In Bangladesh political instability constitutes a serious problem for the insurance industry. The 2003 analytical report published by the Bangladesh Enterprise Institute stated that the insurance industry suffered from undue political interference, fraudulent claims, inadequate risk management and poor quality private sector participation.¹²⁵

3.2.4 PENSION FUNDS

The ADB mentioned in its report that Bangladesh does not have well established pension fund. The term “pension fund” means a pension plan, fund or trust established for the purpose of providing for workers upon their retirement from the workforce.¹²⁶ The pension fund is to be held upon trust for the pension beneficiary, and the pension fund contract may provide for certain ancillary benefits to be paid as well as the primary benefit. These might include compensation for death, illness and injury, or redundancy.¹²⁷ This pension fund is usually created by the employer to facilitate the investment of employees’ retirement funds, which the employer and employees have contributed to. It is a common fund used by workers to generate stable growth and returns through long-term investment over employees’ working years, and payable to them when they retire. Currently, this type of pension fund controls relatively large amounts of capital and represent the largest institutional investors in many nations.¹²⁸

Bangladesh government employees have a pension fund controlled by the government as their employer. This fund is regulated by public sector law and administered by the government, yet remains still completely unfunded and unrecognised as a common trust fund with no regulated institutional investor in managing this fund for investment. Generally, the pension fund is a trust fund and it should be administered by the trustee within a trust and corporate framework. The trust law is usually the governing law referred to for the pension fund’s legal standing. Its legal

¹²⁵ Sobhan, F and Werner W, ‘A comparative Analysis of Corporate Governance in South Asia: Charting a Roadmap for Bangladesh,’ Dhaka: Bangladesh Enterprise Institute, August 2003. The information is retrieved from the Bangladesh Enterprise Institute website, <<http://www.bei-bd.org>>.

¹²⁶ *SIS Act 1993* fund = trust (definition section).

¹²⁷ *SIS Act 1993*,s 61 (trust purposes).

¹²⁸ Investopedia (2011), ‘News and Articles’, India. <<http://www.investopedia.com>>.

position comprises both the institutional and contractual type of investment arrangement governed by a separate entity. In fact, in the pension industry the trustee is a corporate type entity with the pension fund resembling a contractual arrangement.¹²⁹ However, the trustee is not legally a part of the trust because the trustee only invests the fund, collects the earnings and interest and distributes benefits to the fund contributors.

The thesis argues that access to a pension fund should be available to all Bangladeshi workers, not merely those in the public sector and a limited group in the private sector. To do this it will be necessary to establish an independent trustee and a separate trust fund (see Chapter 6) and a regulatory framework (see Chapter 7). These elements are not merely important for improving and the economy and public welfare in Bangladesh. They are also integral aspects of social justice and human rights that are supported by the Islamic faith (see Chapter 4).

3.3 OBSTACLES TO THE GROWTH OF FUNDS IN BANGLADESH

3.3.1 POVERTY IN BANGLADESH MAKES SAVINGS AND INVESTMENT IMPOSSIBLE

Bangladesh is the pioneer in developing the concept of micro-credits to reduce poverty.¹³⁰ It has been celebrated as allowing poor people to participate in the wage-earning process. With good regulations for a nationwide pension system, Bangladesh can adopt an international standard savings plan also that people can contribute to national savings.¹³¹ Bangladesh should extend the contributory provident fund system which currently exists for government employees, as a compulsory measure for all Bangladeshis (See Appendix B). The theory of a nation-wide compulsory CPF might enable Bangladesh to create a sound national savings regime for investment in the domestic and international markets.¹³²

¹²⁹ Bines, HE (1976), 'Modern Portfolio Theory and Investment Management Law: Refinement of Legal Doctrine', Vol.76 *Columbia Law Review* 1784.

¹³⁰ The founder of the Grameen Bank, Professor Dr. Muhammad Yunus, was the Nobel Laureate in Peace for the country in 2006.

¹³¹ Bhuiyan, M (2009), 'Singapore is a successful example in using CPF system in the world: Dreaming for a better Bangladesh', Dhaka <<http://www.momtazbhuiyan.com>>.

¹³² Asher, Mukul G (2002) 'Provident and Pension Funds Governance and Financial Sector Development in India and Singapore', Thailand: World Bank, 10 January <www.info.worldbank.org>.

Unfortunately, Bangladesh is a country where individual income is very low. According to the report of Bangladesh Bureau of Statistics (BBS) published in May 2010, the per capita income in Bangladesh is \$700.¹³³ Yet the WB's threshold is \$975 for a middle class income country.¹³⁴ The total population is about 145 million crammed into a small area of 56,000sq miles. Half of the population is landless and living beneath the poverty level on less than two US dollar per day.¹³⁵ Over the past two decades agriculture in Bangladesh has contributed around 20% as a share of the total GDP, industry contributed 29% share and services contributed around 50%, including 29% solid-cash remittance from migrant workers.¹³⁶ Thus the Bangladeshi economy is not in a good shape and in fact exists on only 24% investment of total GDP.

As a growing economy it is looking for more investment at various levels. Bangladesh has not yet converted the high level of national savings into domestic investment. As is evident from the experience of Australia and India, Bangladesh has the potential to accumulate private savings, pension savings and other national savings for investment, which are still unfunded. Many developing countries have considered pension and provident funds as the source of their social and economic development.

In many Western and Asia-Pacific countries, the accumulation of private savings in the form of pension plans has been very successful in realising people's retirement needs, due to investment in domestic and national levels. This accumulation of pension savings can lead to readily available capital for investment purposes. It is also important to corporate shareholders who may wish to use accumulated savings from the pension funds.¹³⁷

3.3.2 LIMITED ENTITLEMENT IN BANGLADESHI PENSION AND PROVIDENT FUNDS SYSTEM

¹³³ Byron, R.K (2010) 'Per capita income crosses \$700' *The Daily Star*, 28 May, 1.

¹³⁴ BBS (Bangladesh Bureau of Statistics), (2009) *The Statistical Pocket Book of Bangladesh*, 29th ed, Dhaka: BBS Press.

¹³⁵ World Bank (2011), 'Lists of countries of the world by percentage of population living in poverty' <<http://data.worldbank.org/indicator/SI.POV.DDAY/countries>>.

¹³⁶ Objective Analysis: Positive Impact on "Resilient despite shocks, natural and man-made". Dr. Zaidi Sattar, Chairman and Dr. Ahsan H. Mansur, Executive Director of Policy Research Institute <<http://www.pri-bd.org/indexdetails.htm>>.

¹³⁷ Nicoll, G (2006), Note.53

Article 151(1) of the *Constitution of Bangladesh*, 1972 states that “Pension means whether contributory or not of any kind whatsoever payable to or respect of any person, and includes retired pay or gratuity so payable by way of the return or any addition thereto of subscriptions to a provident fund”.¹³⁸ Sec. 5(41) in *Part I of Bangladesh Service Rules*, 1974 states, “Except when the term ‘Pension’ is used in contradiction to ‘pension’ includes gratuity”.¹³⁹ In Bangladesh civil servants receive a non-contributory, unfunded and Defined Benefit (DB) pension, which is indexed for both prices and wages and has fairly generous communication provisions and survivor’s benefits. This pension system consists of 6 types of pensions to government employees only:¹⁴⁰ Compensation Pension, Invalid Pension, Superannuation Pension, Retiring Pension, Family Pension and Extraordinary Pension.

The GPF is available to all government employees subject to completion of two years continuous service. These employees can then join the fund as compulsory subscribers and the CPF which is applicable to every non-pensionable government employee.¹⁴¹ A Bangladeshi government employee may at his or her option join the GPF, even before the completion of two years service. After completing 2 years service, the employee is then required to join the GPF as a compulsory subscriber until he or she attains the retirement age of 57. Recently the retirement age has been raised to 59 years.¹⁴² The employee then discontinues his or her subscription to the fund.

According to the Bangladeshi *General Provident Fund Rules* 1979, ‘all government servants who are not required or permitted to subscribe to the Contributory Provident Fund shall be eligible to join the GPF’.¹⁴³ In Bangladesh, 50% of a government employee’s pension fund must be surrendered compulsorily to the Government for the future pension benefit on the basis of a fixed rate of interest payable to that employee.¹⁴⁴ The government pays into the account of a subscriber, and interest at such rate as may be determined for each year by the government.¹⁴⁵ Every year the

¹³⁸ *The Constitution of the People’s Republic of Bangladesh*, 1972, last modified 2011.

¹³⁹ Government of Bangladesh (1983), *Bangladesh Service Rules (Part-I)*, Bangladesh Government Press, Tejgon, Dhaka.

¹⁴⁰ Howlader, M (1993), *Pension and Retirement Benefits*, Al-Karny Printers, Dhaka-Bangladesh, p. 17.

¹⁴¹ Government of Bangladesh (1979), *The Provident Fund Act of Bangladesh 1925*, Bangladesh Government Press, Tejgon, Dhaka.

¹⁴² Staff Correspondent (2011) ‘Ordinance issued to raise govt service age’, *The Daily Star*, 27 December, 1. As per ordinance promulgated by the President of Bangladesh in confirming the cabinet decision on 20 December 2011 to raise the retirement age of public servants to 59. The *Public Servant Retirement Act*, 1974 was recently amended on 26th December 2011. <<http://www.thedailystar.com>>.

¹⁴³ Bangladesh Gazette, Extraordinary, dated 20th August, 1979, Ministry of Finance Division (Rules Unification cell).

¹⁴⁴ Currently 12.5% interest on contribution to the Provident Fund of Bangladesh.

¹⁴⁵ Sec. 12(1) (5) of the General Provident Fund Rules 1979.

government fixes the rate of interest payable to fund subscribers. With effect from 30 June of each year the government also makes a contribution to the account of each subscriber. This contribution is equal to 8.3% of the pay of the subscriber. Furthermore the Bangladesh Securities and Exchange Commission has made a regulation under the *Mutual Fund Regulations, 2001* concerning the “trust investments scheme” funded by public money.¹⁴⁶

3.3.3 OUTDATED LAW AND REGULATION OF THE BANGLADESHI PROVIDENT FUND

This section considers the history of the Provident Fund in Bangladesh and some of the most significant features of such Bangladeshi schemes. It identifies the most important legal, regulatory and administrative problems in these schemes and where practices in other countries may influence Bangladeshi pension fund schemes in the future.

This chapter identifies a number of important failings in the law governing the present Bangladeshi schemes. The laws with respect to the Bangladeshi Provident Funds are relatively old.¹⁴⁷ The *Provident Funds Act, 1925* is the law regarding government employees’ provident fund system.¹⁴⁸ It does not cover the private sector employees’ provident funds. Most importantly today, the Provident Fund is also restricted in its membership to government public servants. The *Rules 2 (1) of the General Provident Fund Rules 1979* of Bangladesh state that government servants until the completion of two years of service are optional subscribers to the General Provident Fund. This rule is applicable to pensionable government employees. On the other hand *Rule 4(1) of the Contributory Provident Fund Rules, 1979* states that non-pensionable government employees must contribute to this fund. Around the world, participation in pension and superannuation funds has been widened to include employees who are not in government

¹⁴⁶ Securities Related Ordinance, Act, Rules and Regulations, Securities and Exchange Commission, Bangladesh, Generation PPA August 2007.

¹⁴⁷ The General Provident Fund Rules, 1979 and the Contributory Provident Fund Rules 1979 issued under Notification No. MF (RU)-1(5)/79/28, dated 8th August 1979 and No. MF (RU)-1(5)/79/29, also dated 8th August 1979, Ministry of Finance, Finance Division, Bangladesh.

¹⁴⁸ The *Provident Funds (PF) Act 1925, Act No. XIX of 1925* was passed by the Indian legislature. Amended only as an extension of application, it now extends to all of Bangladesh. On the other hand, India has modified this legislation and defined three types of provident funds for its citizens, namely the Statutory Fund, Recognised Provident Fund and Unrecognised Fund. The Statutory PF operates under the provisions of the *PF Act, 1925*. This fund is maintained by government and semi-government organisations, local authorities, railways, universities and recognised educational institutions. The *Employee's Provident Fund (EPF) & Miscellaneous Provisions Act, 1952* of India defines the recognised and unrecognised pension fund. India established the Public Provident Fund (PPF) System for its general citizens to mobilize national savings. The PPF is a government-run fund for the benefit of the general public where contributions are voluntary - up to Rs 70,000 per annum for 15 years.

employment. Western regulatory responses remind us about how well superannuation funds in the U.S. markets have worked.¹⁴⁹

The ADB's 2001 report pointed out the legal and regulatory weaknesses of the pension and provident funds operating in Bangladesh. The ADB remarked that the pension fund administration, investment management, fiduciary requirements, and member protection were of a very low standard. In 2005, Transparency International Bangladesh (TIB) revealed similar findings with respect to the pension system. In particular, the TIB found that 71% of employees had to pay an average BDT 8,000 as a bribe to get their pension from their employer.¹⁵⁰ Both the ADB and TIB suggested reviewing the existing legal framework for the pension, provident fund and insurance industries so that savings could be marshaled as an investment on a trust basis.¹⁵¹ For reasons contained in those findings, the author argues that Bangladesh needs to adopt modern principles of trust law so that a separate and independent trust administration and corporate framework for the pension system can be established. Then it can be tightly scrutinised and corruption effectively dealt with.

Bangladesh's provident and pension funds exist due to the near-century old *Provident Fund Act*, 1925. Structurally, the 1925 legislation stands on the foundation of the older *Pensions Act*, 1871. From these underpinnings, the current legislation has been developed and includes the *General Provident Fund Rules* of 1979, the *Government & Autonomous Bodies Employee's Benevolent Fund & Group Insurance Rules* of 1982, the *Contributory Provident Fund Rules* of 1979, the *Benevolent Fund and Group Insurance Ordinance* of 1982, the *Bangladesh Cha Sramik Kallayan Fund Ordinance* of 1986, the *Companies Act* of 1994, the *Insurance Companies Act*, the *Financial Institution Act* and the Securities & Exchange Commission. Each piece of legislation contributes to the operation of the pension, provident funds and similar schemes.¹⁵² Nevertheless, this legislation does not include modern principles of corporate law as they apply to the pension industry, as seen in more developed countries such as Australia, Singapore and India.

¹⁴⁹ Langevoort, D (2008), note 3.

¹⁵⁰ TIB (2005), *Corruption in Bangladesh: A Household Survey*, TIB, Dhaka.

¹⁵¹ T.A. No. 3590-BAN (2001), 'Pension and Insurance Sector', Funding Agency: ADB (from Japan Special Fund), Executing Agency: Ministry of Finance, Dhaka-Bangladesh.

¹⁵² Laws of Bangladesh, <<http://www.companysecretarybd.com>>.

3.3.4 COMPLEXITY IN BANGLADESHI SERVICE RULES

Rule 337 of Sec. (IV) of Part I of the *Bangladesh Service Rules* of 1953, states in reference to the superannuation pension, “A Superannuation Pension is granted to an officer in superior service entitled or compelled, by rule, to retire at a particular age.” When any government employee attains the age of 57 years as amended, he is entitled to obtaining pension facilities. Alternatively, if any employee satisfactorily completes 25 years of employment and resigns willingly, he is supposed to get a pension benefit as per Sec. 9(1) of the *Bangladesh Public Servant (Retirement) Act*, 1974. In addition, the employee can receive a pension benefit if compulsory retirement is advised in the public interest.¹⁵³ Here power has been given to withhold a pension or any part of it. If the pensioner is guilty of a grave misconduct, the benefit of pension shall not be exercised until the pensioner has had the opportunity to explain his or her conduct verbally or in writing. Furthermore, contrary to the concept of the rule of law, according to Sec. 11 of the *Pension Act* 1871, no action may be taken against the government where failure of its trust practice arises in relation to its administration of the pension system.¹⁵⁴ In Bangladesh we observe an inherent failure applicable to Sec. 11, where the current law requires 50% of employees’ pensions to be surrendered compulsorily to the government for the future benefit of the employee or surrendered on the basis of the fix rate interest payable to that employee. This separation is clearly unfair to fund members because Sec. 11 prohibits this activity from being legally challenged, limiting members’ ability to invest in the competitive financial market.

According to the *General Provident Fund Rules* of 1979, “all government servants who are not required or permitted to subscribe to the Contributory Provident Fund shall be eligible to join the Fund”.¹⁵⁵ Government servants may at their own volition join the fund even before the completion of two years service and discontinue subscription to the fund when they have reached the age of 57. The employee can join a GPF scheme as a compulsory subscriber subject to completion of two years of employment until the age of 57 years.

3.3.5 INADEQUATE TRUST LAW

¹⁵³ Sec. 9(2) of the Bangladesh Public Servant (Retirement) Act 1974.

¹⁵⁴ Sec. 4 of the Pension Act 1871 of Bangladesh. This section also applies to pensions guaranteed or continued after the separation of Burma from India, by the government of Burma.

¹⁵⁵ Bangladesh Gazette, Extraordinary, dated 20th August, 1979, Ministry of Finance Division (Rules Unification cell).

Based on the outdated trust law and complexity of service rules, the author argues that nascent institutions are weak due to inadequate trust law. The author also argues that there is presently no trustee who is independent of the government and someone who can accumulate provident funds for individual members. The current trusts law and trust-administration practice in Bangladesh is reluctant to provide a liberal and independent corporate framework for accumulating trust funds for nationwide commercial use. It is in fact continuing to promote significant failures.

3.3.6 SIGNIFICANT FAILURES – LIMITED TO INTERNAL INVESTMENT ONLY

The first significant failure arising from the imposed limitation upon trust funds in s. 20B of the *Bangladesh Trust Act, 1882*, restricts the amount to be invested will not exceed 25% of the total funds. Furthermore that amount can only be allocated to government listed securities offered on the Bangladesh stock exchange. The economic repercussions of such a statutory restriction such as imposed by s. 20B is the actual rates of return required to provide adequately for the trust fund beneficiaries, will be competitively small and unattractive to both domestic and international investors. It may also mean that Bangladesh will, in the longer term, lose the opportunity to develop valuable expertise in international corporate investment, and portfolio investment management generally.

3.3.7 SIGNIFICANT FAILURES – TRUST ADMINISTRATION

The Bangladeshi Provident Fund for government employees was originally formed as a trust fund under the current regulatory regime. In practice, the government has responsibility for employees' provident fund money, and utilises that money for meeting its budget deficiencies and expenditure. On the other hand, private sector institutions such as universities and businesses having a provident funds system for their employees, apply the accumulated funds according to their own investment strategies. They allocate them without giving employees the option to choose where that money is invested in order to achieve the maximum rate of return; a rate of return which exceeds the fixed rate paid by the government or private employer. Interviews with university and private business office holders also commented that both the government and private sectors were not subject to independent scrutiny of how the fund is managed.

This is essentially the second significant failure in the development of a universally accessible national provident fund in Bangladesh. This failure is contributing to the underdevelopment of the Bangladeshi Provident Fund, and fundamentally compromising its future progress and average workers will not benefit. In time, this significant second weakness will deny vital capital to Bangladeshi corporations, and further hinder the development of principles of corporate law and good governance.

3.3.8 CORPORATE GOVERNANCE

The governance of public pension plans and funds in Bangladesh are managed directly by the government, which makes decisions about how the pension funds are regulated. In the public sector the government maintains a legal status as an employer, not a trustee for its employees. The government also holds the pension funds on behalf of its employees and pays the prescribed interest on funds at the end of the calendar year. These are the trust funds that employees have contributed to and deposited to the government during their employment. According to the modern principles of trust law such pension funds should be invested correctly and be subject to scrutiny. Employees should be given investment options and rights of voting how the funds are supervised and managed so that good corporate governance ensues. Good governance of pension funds is totally absent from the government framework in Bangladesh. Recently a few private sector organisations have started accumulating pension funds for their employees where the same legal fiction exists. Employers are utilising these funds for their own purposes without establishing accountability and legal validity. There is no trustee framework for pension fund governance.

3.4 CONCLUSION

Although there are high levels of poverty in Bangladesh, there exists a substantial and identifiable group of citizens who might help make the Bangladeshi Provident Fund, a universally accessible national pension fund. However, in their reports the WB and ADB identified a number of legal and administrative deficiencies and these need to be addressed.

Two main issues were identified, one centered on the fact that there is presently no trustee who is independent of the government. The other issue involved the lack of corporate governance and the need for this to be rectified. These two issues were identified in the ADB report concerning the insurance industry and pension and provident fund reforms, and therefore relevant to Bangladesh. They will be discussed in more detail in Chapters 6 and 7, and especially the suggestions for overcoming them.

The process for accumulating national savings depends on a highly regulated corporate management environment. Indeed, the economic model of any country relies on the level of national savings. The ADB report encapsulated certain objectives to assist in creating an environment for accumulating and investing pensions, provident funds and insurance funds in the capital markets through the DC pension plan instead of the DB pension plan.¹⁵⁶ The context of the ADB report was based on a two-pronged approach for a progressive liberalisation / deregulation of the insurance and pension and provident funds sectors, and improving institutional capacity. Given this context, the author argues that improvements must include the establishment of an independent trustee, and the development of a new regulatory and supervisory framework. For example, recently, the pension and provident funds played an active role as a significant method of investment by relevant corporations in the developed countries. In Chapters 6 and 7 the author investigates and examines trust law and the regulatory framework, as the best measure for developing new regulatory and supervisory regimes, which were supported by the ADB's recommendations.¹⁵⁷

The context and examination of issues described in Chapters 6 and 7 constitute the core of this thesis. It will confirm the IOPS view that large social and economic benefits will emerge when the savings and regulatory sectors of Bangladesh are comprehensively reformed. This reform is in relation to a universally accessible Bangladeshi Provident Fund within a corporate framework.¹⁵⁸ When a universally accessible pension fund is established, within an independent

¹⁵⁶ *Defined Benefits* (DB) are those benefits which are guaranteed by the pension agency or government, where a pension will be paid based on a prescribed formula in which contributions may not be tied actuarially to benefits. On the other hand, *Defined Contributions* (DC) represent a pension plan in which the periodic contribution is prescribed and the benefit depends on the contribution plus the investment return.

¹⁵⁷ TA 2915-BAN (1997), note 4.

¹⁵⁸ Virgilio T. Velasco and Saitien Thongplengsri (1997) *The ADB Technical Assistance Completion Report, TA 2915-BAN: Insurance and Pension and Provident Fund Reforms*, approved date 20 Nov 1997, Completion date Aug 1999, Division: SAGF,

trustee and regulatory framework, it will provide social and economic justice by removing existing obstacles. It will also facilitate international growth and capital investment for Bangladesh. Many kinds of people, regardless of their employment and social status, will then be able to participate through membership of the Bangladeshi pension and provident funds. This would, in the course of time, become something like an institutional investor or monitor,¹⁵⁹ similar to other developed countries.

Executing Agency: Ministry of Commerce. Velasco is a senior financial economist and Thongplengsri is a young professional, both working for the ADB.

¹⁵⁹ Chapter 5 at 5.3: Studies of Corporate Governance and Corporate Performance. Larcker DF, Richardson SA and Tuna I: “How Important is Corporate Governance”, the Wharton School, University of Pennsylvania, 24 September 2004.

CHAPTER 4: CONTEXT FOR IMPLEMENTING WB AND ADB PROPOSALS

4.1 INTRODUCTION

This chapter examines, firstly, the broader context in Bangladesh for the adoption of a universally accessible pension fund. It considers the Islamic underpinnings for a pension fund system, the extreme poverty of many citizens and the lack of a developed social welfare system, and the profile of those people who might potentially contribute to a pension fund system. This chapter then considers the context in which the particular weaknesses identified in the WB and the ADB proposals in Chapter 3 need to be addressed. Among the difficulties here are the outdated trust law, the lack of education and expertise in trust fund administration, and the lack of a comprehensive regulatory framework for supervising trust funds and their investment.

Some of the most important steps towards the implementation of a universal pension fund in Bangladesh will include: firstly, the establishment of an independent trustee for the separation of pension funds from exclusive government control; and secondly, establishing a broader regulatory system for the corporate and prudential regulation of trust entities and the investment of trust funds. These possibilities are considered in more detail in Chapters 6 and 7.

4.2 CONTEXT FOR ADOPTING A UNIVERSAL INDEPENDENT PENSION FUND IN BANGLADESH

4.2.1 RELIGIOUS FOUNDATIONS FOR SOCIAL JUSTICE

The principles of Islam provide the first foundation in Bangladesh for social justice and meeting the needs of the people in terms of a moral philosophy.¹⁶⁰ One fundamental principle is the Al Zakat – one of the five pillars of Islam. The Zakat requires believers with material and financial wealth to assist others in need. Essentially, the Zakat requires the transfer of an individual's excess property to others under specific conditions. This principle envisages the redistribution of wealth to the poor and needy, by an employer to employees in need, to new Muslims to alleviate financial burdens, to liberate slaves, travelers, debtors, those conducting Islamic missions and the

¹⁶⁰ Haitham A. Al-Zoubi et al (2010), *Debt, Zakat and Optimal Taxation in Islamic Economy*, (Vol. 18, No. 3) Thoughts on Economics, p. 69.

like.¹⁶¹ The principle, its role and its implementation, seeks to ensure that income is equitably distributed and encourages the more affluent to invest and put idle assets to productive use. This redistribution and the encouragement of the productive use of idle assets, is believed to produce a multiplier effect, ultimately improving resource allocation.

The Zakat is compulsorily struck at the rate of 2.5% of the equivalent gold or silver value of the excess wealth or an individual's material effects (the Nisaab). The Nisaab is the valuation of that excess wealth, based on the equivalent value by weight of gold or silver. For gold, this is equal to the value of 87.48 grams, and for silver it is to the value at 612.36 grams. The Nissab applies to the equivalent cash value amount of gold or silver by adding up all cash, stocks, bonds, and other cash assets, etc. to arrive at the total value.¹⁶²

In its actual distribution, the proceeds of Zakat may be summarised as being purposefully directed to relieving poverty and distress, alleviating debt, comfort and convenience of travelers, providing stipends for scholarships, used to pay the ransom price for prisoners of war, propagation of Islam, meeting the expenses of collecting the Zakat, and other material items or benefits to society as a whole. The aim of the obligatory Zakat is not only to benefit society but also to strike at the heart of the one paying the Zakat to curb selfishness and greed.¹⁶³ By implementing this aspect of Islamic faith, Bangladesh can achieve a level of economic and social justice that is cited as a fundamental principle in the Bangladesh Constitution.¹⁶⁴ This religious doctrine buttresses the morality and conscience of the state, and it reminds wealthy citizens to provide for the poor. Furthermore this Islamic injunction serves as a basis for the law and practices relevant to the pension fund.

Both policies are similar in their readiness to redistribute property based on tax-advantaged opportunity. To meet the common aim of the pension fund and Zakat in establishing economic and social justice in Bangladesh, the government should build a universally accessible pension fund for all citizens. There is a substantial and identifiable group of citizens who are earning sound incomes and therefore could provide the first test group for broadening the reach of a universally accessible pension fund in the future. As with John Rawls' theory of social justice,

¹⁶¹ See *Religious Taxation in Islam – Zakat & Khums*, found at <<http://www.azadarijapan.com/showinfo.asp?id=6>>.

¹⁶² Haitham A. Al-Zoubi et al (2010), Note 160, page 72.

¹⁶³ See *Zakat (Obligatory Alms with prescribed rate)*, found in AllIslam <<http://www.alislam.org/pillars/zakat.html>>.

¹⁶⁴ Article 8(1), Part II of the Constitution of the People's Republic of Bangladesh.

the Zakat provides another foundation for the universal provident fund. In this respect, the provident fund is one of a number of government mechanisms (others being the welfare and taxation systems) that can be employed to achieve social justice and political stability.

4.2.2 THE ECONOMY OF BANGLADESH

The economy of Bangladesh is mostly agrarian. Agriculture makes the highest contribution to the country's GDP as can be deduced from the statistics for different economic sectors. Bangladesh witnessed an average growth rate of a little over 5% of GDP between 1996 and 2000 and the projection for the present fiscal year is around 6%. On the face of population growth of 1.47% per annum, this is a very low growth rate. This is also reflected in the low levels of savings and investment in the economy despite some improvement in recent years.

The average individual income per year is approximately Tk. 23000 BDT (depending on fluctuation in the currency), which is equivalent to US \$499 but there is high level of disparity in income distribution. A large number of people live under what is considered to be the acceptable level of poverty. In 2009 the composition of the population was estimated as consisting of 62.7% male and 60.4% female. Bangladesh has a poor social and economic infrastructure and it lacks competitive procurement processes. For example the rural population comprises about 94.8 million people while the urban population has about 28.8 million.¹⁶⁵

4.2.3 THE SOCIAL SECURITY NET

It should be noted that the Bangladeshi government might find it necessary to consider the more difficult question of whether the benefits received from contributions to pension and provident funds should be utilised in making payments to those with no or little income within the general framework for the provision of social welfare in Bangladesh. Ageing is an emerging issue in Bangladesh and it has become an important social concern because like many other developing countries, there is no social security system. Aged persons traditionally rely on their family for their support and care. In Bangladesh the majority of older people live in absolute poverty which

¹⁶⁵ BBS (Bangladesh Bureau of Statistics), (2009), note 126.

is characterised as one of deprivation, ill health and social isolation. The pension system was first introduced in Bangladesh in 1924, primarily for government employees. Bangladesh does not have any national social safety net program like a government sponsored contributory provident fund, medical allowances, unemployment benefits, etc. Consequently the pension and provident fund laws have become outdated and are not relevant for modern times.

In Bangladesh the elderly people usually receive basic security support from their family. The government does not have a policy for providing social security bonuses to elderly people, irrespective of whether they live with their families or otherwise. There is a constitutional commitment to the people of Bangladesh in evolving a retirement and pension system that will be fair, equitable to meet all the fundamental obligations of social security and basic human dignity. Recently the government introduced during the 2011-2012 financial year an Old Age Allowance Program for elderly people, aged women and the disabled.¹⁶⁶ Although very limited in coverage, this is a promising beginning for providing security to the vast majority of elderly people who are not covered by the existing pension system.

In reality, however, it does not cover the definition of a modern pension system. In a modern pension system, the superannuation scheme is an indefinitely continuing fund established as a legal trust in order to provide benefits to fund members or their dependents upon the sickness, death or retirement of the member. Any superannuation scheme adopted by Bangladesh should be developed within a legal framework based on the law of trusts with individuals encouraged to contribute through taxation benefits.¹⁶⁷

4.2.4 PENSION FUNDS CURRENTLY OPERATING IN BANGLADESH

This section outlines the pension and provident funds currently in operation in Bangladesh. A strong legal framework is required for establishing a privately funded pension system and to ensure that system is universally available to all employees. The WB and ADB have documented critical weaknesses in the institutions associated with the administration of these funds (such as insurance companies), and particularly the Ministry of Commerce as a regulator of insurance

¹⁶⁶ Staff correspondent (2011), 'Government pension scheme for the aged and disabled', *The Daily Amadershomoy*, 1 October, front page, <<http://www.amadershomoy.net>>.

¹⁶⁷ Jones, S (2010), *Australian Superannuation Handbook*, Thomson Reuters Australia Ltd, Sydney, pp. 39-65.

companies (see Chapter 3). Additionally the WB and ADB noted the severe shortages in qualified staff, poor leadership, deficiencies in organisation, policies and procedures, and inadequate support from the MOC and the government.

The Bangladeshi government maintains a compulsory GPS and CPF for public servants. It does not offer any compulsory private sector pension schemes, provident funds, and gratuity schemes which could establish national pension savings as a common trust fund. The government is only concerned with government employees where the pension is granted when they retire, and it is based on the length of qualifying service period and the last salary of employment. The maximum pension amount is fixed at 80% of the basic pay drawn. However, the government pays this pension money to its employees from the national budget while developed countries generate this money from their prudential investment strategies. In Western countries, the benefits of pension funds are in tax incentives. The individual participant's contribution in the pension fund is tax-free or a minimal tax is only paid on receipt of a pension after retirement.¹⁶⁸

In Bangladesh, the pension is paid when a public servant retires compulsorily at a certain age fixed by the government. In this context, the Government exercises the *Public Service Act, 1974* to fix the age for retirement. Accordingly the public service employee retires from service when he or she reaches 57 years of age. Recently, on 20 December 2011, the cabinet approved an extension of the retirement age of public servants by two years, up to 59 years¹⁶⁹ and the *Public Service Retirement Act, 1974* was amended on 26 December 2011.¹⁷⁰ Additionally, the government has increased the retirement age for judges and public university teachers to 65 years and 59 years for employee who participated in the independence war of Bangladesh in 1971.¹⁷¹ The major issue here is that the exact birth date is not always known due to non recording of original age in which case date of birth is assumed and rationality of age is lost. Many older citizens in Bangladesh have little or no idea of whether they had contributed to occupational pension schemes during their years of employment. Consequently, they do not know whether they had accrued pension rights with a previous employers' pension scheme.

¹⁶⁸ Cortese, C and Glynn, J (2006) *Taxation and Australia Superannuation System: An Introduction Compression*. NSW: University of Wollongong.

¹⁶⁹ Staff Correspondent (2011) 'Retirement age now 59', *The Daily Star*, 20 December, 1.

¹⁷⁰ Staff Correspondent (2011), note 133.

¹⁷¹ *The Public Servants (Retirement) Act. 1974 & Rules 1975 of Bangladesh*.

The various guidelines/directives issued by the government related to the pension, gratuity, benevolent fund and group insurance are found to be conflicting and inconsistent in their implementation. Despite the *Public Servants Retirement Act, 1974* having been issued after Bangladesh became independent, in the case of providing pensions, other rules, government orders, etc. are either colonial era relics or complicated. The pension administration is controlled by the government and its decisions cause misinterpretation of laws and regulation.¹⁷²

Retirement payments to public sector employees are settled according to the rules of the *Public Servants (Retirement) Act* of 1974. While government employees receive their pension from the government, the officials of autonomous bodies receive their pension from their appointing authority. More recently, a pension fund has been introduced for the benefit of employees of many autonomous organisations, namely universities, nationalised enterprises, banks, etc.¹⁷³ To some extent this represents the establishment of the WB's second pillar. However, the employer organisation might utilise the funds contributed for its own devices. The fund is not kept separate and the trustee of such funds is not independent.

4.2.5 THE PROVIDENT FUND FOR GOVERNMENT EMPLOYEES

According to the last national budget (2008-2009) of Bangladesh the total amount of pensions and gratuities for government employees was 39.7 million BDT.¹⁷⁴ This had been accumulated into employees' accounts and BDT 45.5 million was distributed to them as a state provident fund. Every year, therefore, around 69.5 million BDT are accumulated in the original employees' pension fund.¹⁷⁵

The Provident Fund is one part of a social security program that can be defined as a financial intermediary, usually sponsored by non-financial companies that collect and invest funds. *The Provident Fund Act, 1925* constitutes an important piece of social security legislation but it is restricted to employees of certain government organisations. Under this Act the provident fund

¹⁷² Asian Development Bank (ADB) (2000) 'Reformation of Pension and Provident Funds of Bangladesh', Asian Development Bank's Report, Technical Assistant Documents Database, World Bank. <<http://www.worldbank.org>>.

¹⁷³ Miyan, Alimullah M (2005), note 52.

¹⁷⁴ Economic Detail, Office of the Controller General of Accounts: public account, consolidated fund 2008-2009, Bangladesh.

¹⁷⁵ Economic Detail (2008-2009), note 172.

system was first introduced for government employees in 1982. This Act, being the only statute dealing with provident funds, does not cover the private sector. The different treatment of employees in the public and private sectors highlights glaring flaws in the 'ideal' of economic equality and social justice. In the absence of statutory rules regarding administration of provident funds, uniform policies are not followed by the funds, which were created through bilateral agreements. In some cases unscrupulous employers or trustees use the funds for their own needs.

Only public servants are entitled to a family pension and gratuity. A number of continuing historical features of the Bangladeshi pension system deserve re-consideration. For example, not all public services are pensionable; in certain cases, the employee becomes immediately pensionable while in others this occurs only after two years' employment. If an employee dies during service time, or within five years from the date of receiving the pension, his or her family shall be entitled to receive a benevolent fund grant for a period of ten years. To achieve this, a group insurance fund was introduced by the government and it is managed by an appointed Trustee Board. Only the pensionable services are entitled to a pension, and if any judicial proceeding instituted by the government or employer or any other departmental proceedings are pending against a public servant at the time of his/her retirement, he/she is not entitled to any pension or other benefits. The exception lies in his/her subscription to any provident fund and the interest accrued, till such proceedings are finalised. Even then the payment to his/her of any pension or other benefit can be subject to further processes.

4.2.6 WHO MIGHT CONTRIBUTE TO AN INDEPENDENT, UNIVERSALLY ACCESSIBLE PENSION FUND?

Employees in the public, private and self-employment sectors can contribute to their retirement investment plans if they are offered under a government-backed legal framework. At the same time the civil service and military pension can contribute to the national savings program. Beside this, statutory pension schemes and provident fund schemes for the private sector and voluntary savings schemes for self-employed and co-contributory schemes for poor workers are available. The accumulation of private pension funds or gratuity funds might be added to this national savings policy. The total funds based on this policy can be used as a form of corporate investment

within the regulatory framework. In a broader sense the Bangladeshi provident funds might in time become the major shareholder of the companies in which they invest.¹⁷⁶

Furthermore, one group may be a contributor to pension funds managed by Non-Government Organisations (NGOs). There are about 1,500 NGOs in Bangladesh but their programs are not directed specifically to older people. As a complement to the state sector, NGOs have made many great contributions to public welfare. Micro-credit is one of the most common and increasingly popular types of finance operations developed by NGOs. However, these NGOs work under many constraints and challenges, so that their failings should be seen in the context of a broader picture of governance failure, irregularities and corruption. Undue government interference and control has been an important factor.¹⁷⁷ It has been observed in most cases that those people who sit on the governing body of an NGO were government appointees. The employees of an NGO participate in a provident fund although no separate and independent trustee has been appointed.

Importantly, however, there remains no pension available to a large group of self-employed people working in the agricultural, transport and garment-making industries. Migrant labourers do not qualify for a pension yet there are 20 million labourers who constitute 50% of total employment and their contribution is about 40% of the total GDP. These people have no pension fund system despite the contributions they make to society. These people are of primary interest to the author in considering the potential beneficiaries of a universally accessible fund in Bangladesh. It is this low income group who might receive benefits through a pension fund system in the way that India is now dealing with this problem (see Chapter 5).

More generally, contributions to the pension fund might come from a cross-section of the community and the people mentioned below who would be suitable contributors to a national savings scheme. At various points in this thesis, the author considers theoretical difficulties in implementing a universally accessible pension fund and the weaknesses that have emerged in the administration and practice of trust funds. Unfortunately, there is no literature in Bangladesh addressing these theoretical issues and the difficulties in practice. Partly for this reason, the author draws upon his own original empirical research undertaken to provide some guidance

¹⁷⁶ Nicoll, G (2006), note 39.

¹⁷⁷ Problems of Governance in the NGO Sector: the Way Out, Transparency International Bangladesh. <<http://www.google.com>>.

from practice as to the ways in which theoretical, legal and administrative issues might be addressed (see Appendix A).

It is interesting to note that in the course of the author's analysis, interviewees agreed that in building a universally accessible pension fund it would be necessary to rely on a target group to make the initial contributions. In building the second pillar it might be necessary to target middle and higher income earners and asset holders working in the private sector because they will be able to contribute to the fund. This might be achieved by offering tax exemptions and incentives, or other benefits to contributors.¹⁷⁸ It might even be useful to make these contributions compulsory at least for a short time, as Australia has done. At a later time, the third pillar might be added with voluntary contributions being made by employees during their working life to a general and portable pension fund.

4.2.7 THE WEALTHY WHO RECEIVE A TAX BENEFIT FROM THEIR CONTRIBUTIONS

A fundamental question in establishing a universal pension fund for Bangladeshi citizens would be whether there are enough potential contributors. Since Bangladesh is a poor country a 'target' group may be needed to find out whether the fund could be established in the early stages. The people described below might be considered as the target group(s) who would be suitable contributors to a national savings scheme.

Firstly, the people who have sufficient incomes through their employment to contribute to the universally accessible pension fund would be government workers and members of the existing provident fund. These people effectively provide the first pillar of the WB's 'three pillars' pension system.¹⁷⁹ Secondly, those employees in the private sector and contributing to employer-sponsored schemes might add the second pillar. The primary group of corporate sponsors may be the largest companies and similar organisations.¹⁸⁰ Finally, those people with incomes and assets might contribute voluntarily to a universally accessible pension fund, thus providing the third

¹⁷⁸ See Appendix A: 1.3 Key Findings regarding the author's empirical research.

¹⁷⁹ See Appendix B.

¹⁸⁰ Bines, HE (1976), note 129.

pillar. Such an arrangement, with careful structuring, may effectively meet the description of the WB's three-pillar system.¹⁸¹

4.2.8 THOSE WHO NEED A PENSION FUND

Other groups in Bangladeshi society requiring a pension fund consist of businesspeople or professionals such as registered doctors, lawyers, income tax practitioners, chartered accountants, bankers, engineers, architects and surveyors. Finally, and more broadly, eligible contributors may be sourced from members of professional bodies and associations such as a Chamber of Commerce, Industries or Trade Association. These groups would be expected to fall within the second and third pillars as described above.

A very interesting question would be the possible inclusion of those people famously included by Dr Yunus as 'credit-worthy', but without incomes.¹⁸² Philosophically, in a country with such a pioneering history of recognising credit worthiness amongst the very poor, universal accessibility to the Bangladeshi Pension Fund would seek to accept contributions by credit-worthy people from all sectors of society that derive an income from the primary and secondary industries, or from the professions.

4.2.9 THE TAXATION SYSTEM MIGHT SUPPORT CONTRIBUTIONS TO THE SCHEME

Bangladesh faces another impediment in developing a universal pension scheme and this relates to its taxation system. The tax revenue as a share of GDP in Bangladesh is amongst the lowest in the world. The tax ratio (tax revenue as a share of GDP) is a lean 9 percent in Bangladesh compared to an average of 17 percent for countries with per capita income below USD\$1000, 22 percent for countries with per capita income between USD\$1000 and USD\$17000, and 27 percent for countries with per capita income exceeding USD\$17000. Tax revenue is limited in Bangladesh due to present per capita income being very low. In comparison to its neighboring countries India and Pakistan, Bangladesh should be collecting tax revenues of at least 12-13

¹⁸¹ See Appendix B.

¹⁸² Dr Yunus was awarded the Noble Peace Prize in December 2006 for his work on providing micro-credit to the poor.

percent of its GDP.¹⁸³ Although the tax revenue is low, there is scant evidence to identify how the Bangladesh government pays its employees a 12.5% fixed rate interest for their contributions to the Provident Fund out of its annual budget.

In comparison, people in Australia receive tax benefits for making extra voluntary contributions. The capacity of fund members to accumulate savings through superannuation rests substantially upon the provision of tax incentives to contributories. It is these tax advantages (15% is charged on contributions and earnings of the fund in Australia) that permit the fund to achieve significant amounts in a relatively short time. At present the Bangladeshi Provident Fund is an unfunded DB pension scheme. However, were the scheme to be fully funded on a contributory basis or tax advantage, the refund might be mobilised for investment more easily, reducing the government's perceived budgetary pressure.

4.3 CONTEXT FOR ADDRESSING THE WB AND ADB ASSESSMENTS

In this section the author outlines the context within which the weaknesses identified by the WB and ADB concerning the institutional, legal and regulatory framework will be assessed. While the weaknesses identified by the WB and ADB are accepted they should be seen in the context in which they are addressed. Part of this context is evident in the author's empirical study (see Appendix A). Another part of this context concerns clear deficiencies in existing laws and regulations.

4.3.1 LEGAL FRAMEWORK – OLD LAWS

The laws concerning Bangladeshi pension and provident funds are relatively old and they are too narrowly focused on government public servants; they do not cover private sector employees. There are significant institutional and administrative problems in the Bangladeshi Provident Fund.¹⁸⁴ The Bangladesh service rules virtually reproduce the *East Bengal Services Rules, 1953*

¹⁸³ Ahmed, S (2007), 'Reforming taxes in Bangladesh: A tax payer's perspective', *The Daily Star*, Front page <<http://www.thedailystar.net>>.

¹⁸⁴ TA (1993-2000) 'Performance of Pension and Provident Funds in Selected Developing Member Countries', Technical Assistance Performance Audit Report, Asian Development Bank, 12 August <www.adb.org>.

(Part I and Part II) and the revised pension rules and rates and retirement benefits issued by the old East Pakistan government are still considered in the payment of pensions. Ordinary pensioners scarcely understand the various government rules and regulations concerning their pension and retirement benefits. The length of time required to process pension payments adds further to a painful experience. However, most significantly, while the growth of pension funds internationally has served to connect the law associated with pensions plus superannuation funds with investment trusts, and therefore with the governance of corporations, this has not yet occurred in Bangladesh. This is an important failing, since Bangladeshi funds may find it difficult to produce the rates of return required to adequately provide for pension fund beneficiaries.

At the same time, it means that Bangladesh may be losing the opportunity to develop valuable expertise in international corporate investment, and portfolio investment generally. It also means that Asian sub-continental countries may fail to modernize their systems by failing to accept many principles of corporate law and governance, which have been closely associated with the worldwide pension fund revolution.¹⁸⁵ However, the pension or superannuation law is an area of wealth creation that is constantly changing. In that sense the Bangladeshi government- provident fund system for government employees and the private sector's provident fund system for private employees need to adapt the modern corporate principles of trust administration for managing the provident funds. The Bangladeshi *Trusts Act*, 1882 is too old to contribute to the proper management of funds.¹⁸⁶ It is an Act for governing the trust funds/pensions funds of Bangladesh. The general provident funds rules can be considered to be obsolete.¹⁸⁷

In Bangladesh asset management companies are rare and therefore cannot manage public or private funds in terms of a trust structure. The question of capital guarantee has been debated in the context of mutual fund management in the private sector, although SEC did enact the *Mutual Fund Regulation*, 1997 but later replaced it with the Securities and Exchange Commission (Mutual Fund) Rule, 2001. The absence of a corporate culture in Bangladesh is the main factor

¹⁸⁵ Holzmann, R and Hinz, R (2005), note 79

¹⁸⁶ The *Trusts Act* 1882 of Bangladesh.

¹⁸⁷ The *Public Servants (Retirement) Act* 1974. The General provident Fund Rules, 1979, Bangladesh (East Pakistan) Service Rules 1947.

militating against decentralising the entire pension system. There are not enough skilled fund managers who can control the risk, identify and exploit capital market inefficiencies.

Furthermore the capital market in Bangladesh is not stable. Sometimes it reacts to adverse movements such as rising interest rates, volatile exchange rates and failing equity prices. The instability of the political situation of Bangladesh creates a contagion and puts mortgages and real estate securities at risk. The legal system suffers from non-compliance with the rule of law, legislation, regulations, practices and standards such as contractual obligations. Good corporate governance practices have not yet been adopted in Bangladesh due to legal and regulatory deficiencies in the pension system. These problems are aggravated by the labour laws not being properly maintained. The social protection or safety nets are merely stated and not actually implemented. In fact no system has yet been configured so that society benefits. Government employees enjoy a little benefit under the law but other social groups such as those working in agriculture are fully deprived of these facilities.

There is no privatisation law to lend transparency and authority to the privatisation process, although one is at present being drafted. The current banking sector is faced with a substantial number of bad loans; non-performing assets account for about 30% of total assets. There are not many institutional investor/ private fund management companies in Bangladesh. In 1997 the SEC enacted a regulation to encourage investment by private companies. This regulation states that an assets management company will play the principal role in fund and trust management. However, the law restricts investment by such investment companies to investing no more than 40 percent share of the company's funds. In practice this is a complex issue.¹⁸⁸ The SEC actually has no authority to issue rules and regulations, and the procedures as a whole are long and drawn out. Domestic investors continue to exhibit a lack of confidence in the capital market, especially in the secondary securities market. Only a limited number of foreign investors are showing interest in the capital market of Bangladesh.¹⁸⁹

¹⁸⁸ Moin Al Kashem (1999) 'Problems in provident fund system of Bangladesh', *The Prothom Alo*, 28 July, 1.

¹⁸⁹ Regulating institutional investments for capital market development, Barrister Tureen AfroZ, *Law Opinion*, Oct 10, 2004.

4.3.2 THE TRUSTEE PROBLEM IN BANGLADESH

The *Trusts Act*, 1882 is unable to regulate current trustee relationships concerning fund investment and management. Due to the absence of a dedicated set of regulations and necessary infrastructure, the 1882 statute fails to consider capital market activities. The trusteeship of debentures has in effect become an unaccountable and defunct institution. The *Trusts Act* has not explicitly mentioned the account and governance requirements for business and financial matters. However, Section 20B of the *Trusts (Amendment) Act*, 2000 permits both public and private pension and provident funds to invest up to 25% of their total funds into listed securities.¹⁹⁰

The 1882 *Trusts Act* was created during the colonial era for commercial reasons. It does not contain modern commercial aspects to support capital investment within a corporate framework. However, Section 20 of the Act does comment on the investment of trust money into the government portfolio. This section does not encourage the investment of private fund into the privatised investment management because Sections 20 (c) and 20 (d) of the 1882 *Trusts Act* do not govern the private investment system. Additionally, Section 20B deals with the investment of trust money in company securities, but is not consistent with the modern corporate principles of accumulated national savings or pension savings. Section 20B prohibits bringing any corporate major shareholders into both the domestic capital market and international financial market. Trust law is very important in the corporate sector but the Bangladeshi *Trusts Act* does not support the modern corporate standard for marshalling savings and fund investment. Although government regulator has introduced some reforms over the years, these reforms are unrealistic in that they still do not secure legal protection for investors.¹⁹¹

Bangladesh inherited many English laws, including the *Companies Act*, 1913 (as amended in 1994), the *Contract Act*, 1862, and labour laws, along with various securities regulations including the SEC Public Issue Rules. These now provide an insufficient framework in Bangladesh for meeting the demands of a modern pension fund with taxation incentives. Owing to the absence of a clear regulatory regime, the system failed to govern the trustees' responsibility, which created an environment on non-accountability. The *Trusts Act*, 1882 is

¹⁹⁰ Moin Al Kashem (1999) 'Problems in the provident fund system of Bangladesh', *The Prothom Alo*, 29 July, 2.

¹⁹¹ Soloman S. M. (2006) 'Recent reforms and development of the Securities Market in Bangladesh', *Journal of Asian and African Studies*, Vol. 41, No. 3, pp. 195-228.

focused only on allowing provident and pension funds to invest in the capital markets. Equally, the political environment is so fragile that laws and applicable regulations are not being fully enforced.¹⁹² In the United Kingdom and Australia, trustees typically have ultimate control of the investment policy of pension funds. However, employers tend to influence the attitudes of trustees, directly or indirectly, and in our experience the attitude of company management towards equity investment tends to be a very major factor supporting the current tendency for many funds to be heavily mismatched.

4.3.3 THE REGULATORY FRAMEWORK – OLD SYSTEM

The Provident Fund in Bangladesh benefits chiefly public sector employees and a limited group of workers in the private sector. Workers in agriculture and other private businesses including garments and transport are not covered by any pension fund; nor are migrant or overseas workers in Bangladesh. Furthermore, the pension and provident funds of Bangladesh are not ‘portable’ so that workers are not able to take their funds with them when or if they change employers within the country or from country to country.¹⁹³ Whilst India has now adopted the portability principle and Indian workers may take their pensions elsewhere in the world, this is not a possibility open to Bangladeshi workers.¹⁹⁴

Despite reforms in the financial sector, Bangladesh continues to find weaknesses in its pension fund system. One core reason for this is the poor governance of corporations and trust funds.¹⁹⁵ This country did not appear to have put in place reforms required to access global diversification on its portfolios. Policy level and institutional arrangements to provide social security to the elderly outside family is quite limited. It does not fulfill constitutional obligations of social security for the elderly and does not conform to the needs for basic human dignity. Essentially,

¹⁹² Bangladesh Survey, Mikael Kviback, Bangladesh Bank, National Savings Bureau, Dhaka Stock Exchange. <<http://www.google.com>>.

¹⁹³ *Superannuation Industry (Supervision) Act* 1993 refers to Australian public offer funds.

¹⁹⁴ Miyan, Alimullah M (2005), note 52.

¹⁹⁵ Shah, A, Thomas, S and Gorham, M (2008) *Indian Financial Markets: An Indian's guide to how the markets work*, Elsevier, Bombay.

the Bangladeshi pension funds are a complex form of ‘inter-generational contract’,¹⁹⁶ and need to be reformed so that they operate according to modern corporate principles.

4.3.4 INVESTING THE FUND – MARKETS IN BANGLADESH

In Bangladesh the institutional investor community such as investment and merchant banks, mutual funds, pension and provident funds, life insurers, etc., has unfortunately not developed because there are many impediments. The market is essentially retail-based and prone to high risk. The newly licensed merchant banks are yet to make any tangible mark, the government pension funds are essentially non-funded and non-accounted-for liabilities. Provident and insurance funds are restrained by age-old qualitative and quantitative restrictions and the growth of private mutual funds is retarded by a stringent regulatory framework and an uneven playing field. None of these basic realities has been conducive to growing a healthy and vibrant capital market.

The capital market is yet to emerge as an effective investment avenue for most small savers on one hand and attractive avenue for corporate bodies wanting to raise funds on the other, especially since the ‘boom and bust’ of 1996. The negative spill-over effect of the grim capital market performance in that year dampened the potential public issue of debt securities. However, the recent resurgence of the market has witnessed a renewed appetite for investment grade securities which could unleash a fresh demand for listed debt securities. Bangladesh’s capital market is weak in that it lacks the foundation of an efficient capital market. The securities market is similarly weak in its legal and regulatory framework. There is a major absence of active market professionals and there is no adequate legal protection for investors. It lacks a competitive procurement process.¹⁹⁷ Currently, various programs are being designed to increase market capacity and transform the capital market so that it is fair, transparent and efficient, in order to

¹⁹⁶ Roundtable Report (2004), note 84.

¹⁹⁷ Staff Correspondent (2008) ‘Economy and trade in Bangladesh’, *The Daily Observer*, 16 May, 3.

attract more investment capital.¹⁹⁸ The provident and pension funds at present are not helping in the development of capital markets.¹⁹⁹

The private mutual funds regime has not been developed yet to mobilise savings to be invested in the debt market in Bangladesh, and consequently the new investor companies are not profiting from the ICB's monopoly. There are provident and pension funds (with an approximate total amount of BDT 10 billion), self-managed by public and private organisations, but none are professionally managed within a corporate framework so that a higher and competitive market returns are targeted. The government's pension obligation is not funded. The employee's pension and provident fund represent one kind of fund. In reality, the *Trusts Act* of 1882 prohibits those funds from being invested in equities, corporate debentures and private money market instruments. There are no protective laws in effect to ensure that investors will get their dividend and capital back. Missing are higher audit standards together with SEC regulations on disclosure standards in the prospectus along with arbitrary institutions.

4.3.5 PARTICIPATION OF INVESTMENT FUNDS IN A UNIVERSAL SCHEME

Bangladesh reports as having approximately 40 or more mutual funds, 37 of which are listed on the stock exchange.²⁰⁰ India and Pakistan appear to have significantly large equity markets and indeed the size of the market in Bangladesh can most likely support a nationwide pension scheme. According to the amended rule concerning the regulation of mutual funds by the Securities and Exchange Commission (SEC), this ruling imposed a prohibition on the mutual funds from using new shares either in the form of right or bonus shares to increase their capital bases. The SEC also imposed restrictions on mutual funds asking them not to offer pre-emptive rights shares or private placement.

Although mutual funds are widely known as open-end mutual funds in global capital markets, most of the mutual funds in Bangladesh are close-end mutual funds. The amended rules raise

¹⁹⁸ Financial Sector Assessment Program (FSAP) (2009) 'Program for Financial Assessment of Bangladesh' IMF and World Bank. 25 January <www.imf.org>.

¹⁹⁹ Asian Development Bank (ADB) (2006) 'Reformation of Pension and Provident Funds of Bangladesh', Asian Development Bank's Report, Technical Assistant Documents Database, World Bank. <<http://www.worldbank.org>>.

²⁰⁰ Staff Correspondent (2011), 'Bad days not removing for Mutual Funds', *The Daily Amadershomoy*, 7 October, front page. <<http://www.amadershomoy.net/content/2011/10/07/news0195.php>>.

some questions and concerns about the quality of Bangladeshi financial securities and its capital market. Due to SEC's favouritism toward the ICB and lack of private mutual funds in the Bangladeshi capital market, professional portfolio managers are not coming forward to manage this fund.²⁰¹ These are the major impediments to the growth of private investment companies and a competitive mutual fund market in Bangladesh.

4.4 CONCLUSION

Considering the enormous political and social difficulties that Bangladesh has faced over many decades, some co-ordination of the country's welfare and taxation system with the benefits of a universally accessible private pension fund system is called for. A targeted socio-economic group and re-organised tax system would generate greater social justice that has been underpinned by religious beliefs and government action. At the same time it would relieve the impossible burden on government welfare since so much of the population is poverty-stricken. The key to doing this is to break the cycle of low incomes, poor savings levels and low investment. Improving the capacity and governance of government bureaucracies is important if this is to develop.

Bangladesh as a whole needs to encourage financial education and develop expertise within its bureaucracy, and to establish pension savings through various and mandated schemes. In a country like Bangladesh, where social security measures are insignificant, insufficient and individuals do not have the ability or circumstances in which to plan or provide for their old age, the government and private employers have a significant role to play in financial and public education. Achieving real change will require a significant re-organisation of financial and trust administration.

There is much potential for achieving greater efficiency and greater equity by making relatively simple changes in laws, regulations, administration and governing practices concerning Bangladeshi provident and pension funds. A strong Pension Regulation Reform Commission should be established to co-ordinate government and private employment sector involvement in this issue. The government may consider reducing the traditionally centralised control of the pension system so that new pension fund trustees and investment managers can operate in the

²⁰¹ Staff Correspondent (2008) 'People's right to know', *The Daily Star*, 1 September, 1.

financial system. In this way, presently ‘nascent’ institutions may be encouraged to develop further. It may be time to adopt some of the most beneficial features of a three-pillar pension fund system in Bangladesh. Doing so would allow the country to participate in international investment for the benefit of all its citizens.

CHAPTER 5: MODELS FOR THE WORLD BANK'S THREE-PILLAR SYSTEM: COMPARISONS WITH INDIA AND AUSTRALIA

5.1 INTRODUCTION

The options available to Bangladesh in advancing a three-pillar pension fund are examined in this chapter, in the light of the deficiencies already identified by the WB and ADB (see Chapters 3 and 4).²⁰² The thesis argues that implementing the three pillars will ultimately ameliorate entrenched poverty, enhance national savings and marshal the pension funds for investment. The WB has proposed a 'three-pillar' approach as the ideal way to alleviate Bangladesh's problems, and provided clear reasons for a universally accessible national pension fund. Together, both the WB and ADB identified clear benefits and values of the 'three-pillar' system. Benefits in particular, can be seen in the number of the countries adopting the three-pillar system,²⁰³ such as those arising from philosophical reasons ranging from establishing social justice and reinforcing religious traditions. However, implementing the three pillars will also require major structural changes.

In the first section of this chapter the author provides a review and overview of the lessons to emerge from Asian and other developing countries. Closer to home in Bangladesh, there is little guidance currently available as to the establishment of the first pillar in the public sector while the second and third pillars are presently non-existent. India, Pakistan and Bangladesh were all British colonies but more recently India is providing a significant lead for the region. As a result, India provides ready guidance in implementing co-contributory provident funds – a first step towards the universally accessible fund. India has recently gone some distance towards implementing the WB's recommendations on the second and third pillars. For example, it has reviewed its older trust law and established a new regulatory regime. For these reasons, India provides a natural model for Bangladesh to consider. Australia, on the other hand, provides an example of a well-established three-pillar superannuation fund regime which provides a valuable benchmark for the developing Bangladeshi pension system.

²⁰² World Bank (2006), note 12.

²⁰³ *Ibid.* The World Bank reported that since 1984, 68 countries have been helped in reforming their pension systems by following the three-pillar strategy.

5.2 A COMPARISON OF PENSION FUND SYSTEMS IN DEVELOPING COUNTRIES

5.2.1 CHILE – AN EARLY BENCHMARK IN PRIVATISATION

Chile's pension fund system is an important example for Bangladesh because it provides the technical means of privatizing pension funds. Chile first began this pension fund within a corporate framework. This fund started in 1924 as a mandatory pension system which was organized around private and State-managed social security institutions for particular groups of workers. In 1952, a significant pension reform took place which was actually unsuccessful in reducing the disparity in pension contributions and benefits.²⁰⁴ Chile's actual pension reform took place only in 1979-1980 and was designed and implemented by a group of economists. In 1979, before the 1981 pension reform, the government began a strategy to improve its fiscal policy by attaining a significant and systematic general government surplus.

Chile adopted a broad and deep program of structural reform by developing its banking and capital market sector rapidly. Chile's capital market liberalization program helped develop new financial instruments and industries, including insurance savings, bond markets, mutual funds and risk-rating agencies. A sound regulatory framework provided a significant development in Chile's capital market and banking sector. Private pension fund assets increased to 35% of GDP in 1990, and pension funds currently hold significant shares of Chile's equity, bank deposits and public debt.²⁰⁵ Chilean pension reform is evidence of how to improve labour markets by reducing the pure tax component of pension contributions. Chile's three-pillar pension system has been criticized because it has not solved fundamental fiscal, financial and macroeconomic problems. The Chilean government has instituted a welfare pension plan for the poorest elderly who are means-tested to screen out beneficiaries who already have significant income or assets.²⁰⁶

Chile's pension reform is very beneficial to its citizens. It has fully replaced the state-run pay-as-you go system with one of retirement savings accounts that are owned individually and managed by the private sector. However, it is important to note that pension privatization in Chile was introduced as part of a coherent set of radical free market reforms, with the understanding that implementing such changes simultaneously was the best way to increase economic growth and

²⁰⁴ Schmidt-Hebbel, K (1999), 'Chile's pension revolution coming of age', *The Cologne*, Germany.

²⁰⁵ Schmidt-Hebbel, K (1999), 'Pension System, Social Security, Growth, JEL Classification', Klaus Schmidt- *The Cologne*, H 55, 041, 054.

²⁰⁶ Olive, M (2005), 'How well has Chile's Retirement Program Aged?', *Knowledge@Wharton*, Sept. 7.

get the most out of each reform. As a result, the growth rate of the Chilean economy doubled from its historical level to around 7% a year for more than a decade.²⁰⁷

The Chilean pension model is a radical alternative to the social collectivism initiated by German Chancellor Otto Von Bismarck at the end of the 19th century in Germany, which served as the model for the welfare states of the 20th century. Notably, China, the world most populous nation other than India, has recently been studying ways to solve its pension crisis by adopting a system based on the Three Pillar System, as prescribed by the World Bank for individual retirement accounts.²⁰⁸

The former President of the United States, George W. Bush, made a principled case for pension reform:

My plan reforms social security so that every worker can be a saver and the owner. There is no human dream stronger than the dream of having something you can call your own. It is the promise of America. It is the promise of independence and dignity.²⁰⁹

Chile's experience is very illustrative in that it points to sizable efficiency gains in pension markets helping to raise social welfare and economic growth. This model has a particular relevance for the Indian subcontinent. The Chilean model advocates taking completely away the provident funds from government control so that they can be managed by smaller fund managers but strictly supervised by the government with proper guidelines.²¹⁰ Bangladesh may have to heed the necessary technical lessons from Chile use them to reform its pension and provident funds system.

5.3 PENSION SYSTEMS IN OTHER ASIAN COUNTRIES

The development of pension funds in Asia has been associated with the alleviation of poverty. However, the experience of south Asian countries in operating pension funds constitutes a poor history. Their various publicly managed pension schemes delivered poor returns. Recently, however, the Asian countries including India have moved to privatize government enterprises in

²⁰⁷ Schmidt-Hebbel, K (1998), 'Pension System, Social Security of Chile', *The Cologne*, no. 33, April, pp. 25, 29.

²⁰⁸ Pinera, J (2001), 'Liberating workers: The World pension Revolution', Cato Institute, USA.

²⁰⁹ Pinera, J (2001), 'George W. Bush, at Western Michigan University', Kalanzoo, March 27.

²¹⁰ Venu, M.K (2006), 'India considers the Chilean Model', *The Economic Times*, 27 May <<http://www.josepinera.com>>.

corporate investment sectors to ensure the highest rate of investment returns.²¹¹ Many Asian countries have reformed regulatory frameworks concerning pension funds investments.²¹² These countries have ensured that the capital markets have a strong corporate culture, good regulations and compliance features, a reputable trustee regime, political non-interference and sufficient transparency.²¹³ The worldwide revolution in superannuation schemes indicates that pensions are an effective way of creating income and reducing poverty during old age.²¹⁴

The excellent examples provided by Malaysia, Singapore and Chile illustrate how a credible and well-run pension system which can accumulate long-term resources rapidly can be achieved. In Singapore, the resources of the Central Provident Fund rose by 28% of GDP in 1976 to 73% in 1986 and 76% in 1990 and 80% in 2010 of total GDP. In Malaysia, provident fund assets grew from 18% of GDP in 1980 to 41% in 1990 and 75% achieved nearly of total GDP in 2010.²¹⁵

Most OECD countries are implementing accumulation-style pension fund systems, as distinct from DB systems.²¹⁶ In Singapore and Malaysia, most pension funds are invested safely in government bonds and other debt instruments, with only a very small proportion going into equities. However, Singapore and to a lesser extent Malaysia, allow workers to invest their provident fund balances in housing and other approved securities. Singapore has recently permitted investments in foreign securities, and Malaysia is likely to follow suit. In Singapore the contributory provident fund system is compulsory to all employees and employers based on their incomes.²¹⁷ At this stage, when considering the Malaysian, Chile and Singapore models, the author notes that the Singaporean pension model has demonstrated how a universal pension fund can be created and extended to all citizens.

²¹¹ Asher, Mukul G (2005) 'Recent Social Security Reforms in Selected Asian Countries', Delhi Conference, 5 March <<http://www.worldbank.org>>.

²¹² OECD (2004) 'Funded Pension Schemes for Government Workers: Proposal for Study', Manila Conference, OECD No. 4: 30 March <<http://www.oecd.org>>.

²¹³ Asher, Mukul G, and Nandy, A (2006) 'Reforming Provident and Pension Fund Regulation in India' 14 *Journal of Financial Regulation and Compliance* 273.

²¹⁴ African Government Report (2006), 'Social Pensions', Help-Age International, London N1 9ZN, UK <<http://www.helpage.org/download/4c48d8bb4513c>>.

²¹⁵ National Central Bank Report (2006), 'Chile GDP statistics and forecasts; Chile economic, financial and trade information; best banks and safest banks in Chile', <<http://www.gfmag.com>>.

²¹⁶ OECD/INPRS (2004) 'Reforming Pension System in South-East Asia', Third Manila Conference, OECD, 17 December <<http://www.oecd.org>>.

²¹⁷ Asher, Mukul G (2002) 'Provident and Pension Funds Governance and Financial Sector Development in India and Singapore'. Thailand: World Bank, 10 January <<http://www.info.worldbank.org>>.

5.3.1 PAKISTAN - PENSION FUNDS UNDER CONSTRUCTION

The pension funds system of Pakistan is significant to Bangladesh because both countries have similar legal and historical socio-cultural backgrounds. Pakistan has been reforming its pension and provident funds in accordance with the direction of the Capital Market Development Program (CMDP) approved by the ADB.²¹⁸ This indicates that its review of all the major aspects of the existing social, economic and financial security system was successful. A regulatory framework was implemented by the Pakistani government in 2008, on the advice of an independent pension regulator in 1997. The regulatory institution will review the existing regulatory framework, and prepare proposed modifications to regulations or necessary legislation to develop an enabling legal, regulatory and institutional framework for pension and provident funds. It will identify the issues that are compromising efficient service and professional management of pension and development fund schemes in Pakistan, and prepare recommendations to alleviate them.²¹⁹

5.3.2 CHINA – A PENSION FUND IN CRISIS AND REFORM

This section describes China's struggle to solve its pension crisis. China has prioritized the pension fund system so that it is a fully funded one. The Chinese government is trying to accumulate all retirement funds professionally, and give to the workers a wider range of investment options. China thinks that the privatization of a pension system is the best way to radically reform China's financial sector. However, realistically, China's thinking is that to make a successful and pension reform possible, workers require more access to investment markets in order to obtain competitive rates of return. This reformation must be accompanied by private sector fund managers having free access to the capital markets, freedom of investment options offered by both national and international markets and moreover freedom from political interference especially in private pension fund management.²²⁰ A recent development concerning corporate businesses dealing with the sovereign wealth fund of China has become increasingly popular in attracting global financial investment. The sovereign wealth fund acts as China's

²¹⁸ TA 2867-PAK (1997) 'Pension System of Pakistan', Technical Assistance Report, Asian Development Bank, 7 April <<http://www.adb.org>>.

²¹⁹ Mahmood, N and Nasir, Z (2008) 'Pension and Social Security Schemes in Pakistan: Some Policy Options' 42 *Pakistan Institute of Development Economics* 39.

²²⁰ James A. Dorn (2004), 'A fix for China's Pensions', *The Asian Wall Street Journal*, February 9, <<http://www.josepinera.com>>.

investment arm. The China Investment Company (CIC) has been successful by investing its fixed assets so that currently the country's GDP has reached nearly 50%.²²¹ The lesson from China is that Bangladesh might adopt the same strategy in employing its pension funds and foreign remittance as a sovereign wealth fund for wider investment.

5.3.3 MALAYSIA – BRINGING THE FUND TO PROFIT

The Malaysian pension funds system is described here because it provides a good example of how Bangladesh can create a pension fund that acts as a sovereign wealth fund within an institutional framework. In Malaysia, pension funds have created substantial holdings of foreign equities and bonds since the relaxation of investment rules in the early 1980s. These holdings range from well over 50% for the typical pension fund in Hong Kong to over 20% in Australia, New Zealand and the UK. In Malaysia employers and employees are required to contribute to the fund on a monthly basis. The fund then accumulates to become the workers' retirement fund. The contributions of 11% of the employee's salary and 12% of the employer's share are combined to form the Malaysian Employees' Provident Fund (EPF). These employers' and employees' contributions are encouraged in Malaysia for the purpose of increasing the capital of the trust fund for investment. The funds are well regulated.

As an investment-worthy fund, the Malaysian Employees' Provident Fund (EPF) has attempted to operate as a portfolio investor and not as a promoter or a major shareholder in individual companies. The EPF assumes only a portfolio risk in the investments it makes. In fact the independent directors mostly generate the value for the funds of shareholders and it may be an institutional defense mechanism.²²² The Malaysian Central Bank (BNM - Bank of Negara Malaysia) has been active in a wealth creation scheme known as the PIP or people-in-profit

²²¹ Surowiecki, J (2007), 'Sovereign Wealth Funds: Investment Funds', *The New Yorker*, November 26, <<http://www.newyorker.com>>.

²²² Langevoort, D (2008), 'As a Lawmaker: Choice about Investor Protection in the Face of Uncertainty', University of Virginia, Harvard, USA Faculty Working Papers, 2008, p. 23.

scheme which was recently criticized by the Australian government and declared illegal according to Australian law.²²³

5.3.4 THAILAND— DEALING WITH AN AGEING POPULATION

The Thai pension fund system is a comparable one because it functions to reduce poverty in old age. The pension fund system in Thailand is different in the public and private sectors. The Thai pension fund system has many problems when it is measured against the World Bank's recommended multi-pillar system. In the private sector there is a scheme called the "old aged pension fund" (OAPF) which is administered by the Social Security Office. According to the country's Social Security Act three parties contribute to this pension system - the employer, the employee and the government.²²⁴

In the public sector, however, the provident funds system in Thailand has been encouraging private sector employers to save for retirement since 1987. The contributions paid to the provident fund by the employees and employers are tax deductible and the benefit payment is tax exempted. The government is struggling for reformation its pension system and trying to adopt international corporate governance and the principles of IOPS in pension funds investment.²²⁵ In 2005 the SEC of Thailand introduced new regulations permitting provident fund managers to offer members investment choices. The regulations state that a conservative option must always be offered. In addition other options can be offered but the fund manager must specify clear investment policies for each option which ensure that good corporate practices are carried out in the Thai financial market.²²⁶

5.4 DEVELOPMENTS IN PENSION FUNDS IN INDIA AND AUSTRALIA

²²³ KPMG report (2005), 'International Survey of Corporate Responsibility', Global Sustainability Services TM, Amsterdam Graduate Business School. <<http://www.kpmg.com.au>>.

²²⁴ Kanjanaphoonin, N (2004), 'Pension Fund, Provident Fund and Social Security System in Thailand', Collaboration Centre, Tokyo, Japan, 13-24 Feb.

²²⁵ Kaul, V and Dharamsi, K (2010) 'New Pension Scheme' 1 April <<http://www.dnaindia.com>>.

²²⁶ Holzmann, R and Hinz, R (2005) 'Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform', Washington, D.C.: World Bank, 23 February <<http://www.info.worldbank.org>>.

In this section the author reviews developments in Australia and India. This is because they represent, respectively, a modern developed (if small) Western country and a major developing South Asian power with which Bangladesh shares a close history. Australia and India have implemented a pension fund system that is now providing many benefits. This research will use the Australian superannuation system as a benchmark because it has operated efficiently and effectively to date. However, the revolution in pension funds has emphasized the importance of local financial market developments. Pension funds and capital markets can both support and thrive under the right macroeconomic policies – low inflation, small budget deficits, and positive long-term real rates of investment.²²⁷

The pension and superannuation funds are not only sources of long-term savings to support the development of bond and equity markets, but they can also serve as a positive force for supporting voluntary regulatory mechanisms for good corporate governance and privatization. At the same time, capital markets offer pension funds, the opportunity for better portfolio returns, tax thresholds and risk management. This interaction is a long, self-reinforcing process that creates sound macroeconomic policies, strategy, effective regulatory reforms, and international standards of accounting, and a legal and transparent information system.

5.4.1 DEVELOPMENTS IN INDIA – THE NEIGHBOUR AS A PROGRESSIVE LEADER

In this section the author considers important developments in India that are relevant to Bangladesh. Importantly, India has extended its provident fund to include not just government workers but non-government employees and low income citizens as well. The provident fund now receives deposits from this wider group which is unable to withdraw its deposits until the age of 60. In this way the provident fund now functions as a welfare support system for Indians. These developments are yet to occur in Bangladesh and the author argues later on in this thesis that while a trustee who is independent of government and a regulator may be ideal developments, India's strategy may provide the best way forward for Bangladesh.

Indian employees' provident fund is the world's largest pension fund in terms of number of participants, covering over 23 million civil servants. A recent reform in India has introduced a portfolio DC pension scheme for new entrants, with government contribution matching that of

²²⁷ View points, The World Bank, Note No: 71, Feb,1995, documents no: 16930. <<http://www.info.worldbank.org>>.

employees'.²²⁸ India appears to have significantly large equity markets.²²⁹ The growth of the financial sector in India also appears to have reached a level of financial market preparedness so that investment in funded DB and DC schemes can be controlled. Employers and employees contribute 15% of their salary to the scheme. In the context of an insurance DB scheme offered by insurance companies, full funding is guaranteed by insurance companies' actuarial valuations which are carried out every year. In the case of self-managed DB schemes, the trustees are responsible for ensuring full funding of the schemes. Most pension funds in India are now required to buy an annuity from a life insurance company when an employee retires. Benefits are paid to members upon reaching the statutory defined retirement age of 60. In 2004 India tried to turn the pension and provident funds in the financial markets into a form of national savings. India has made a regulatory framework so that pension savings can be mobilised in the corporate sector.²³⁰

In India, a minimum of 80% of the employee's provident fund assets must be invested in public bonds. Generally, this tends to restrict the scope for investing the provident fund assets. Public bonds are in some cases non-tradable and in other cases subject to regulations restricting asset allocations. Some investment bonds are subject to maximum limits or can only buy equities that exceed a generally higher rating classification. This constrains the fund manager's investment strategies and reduces the capacity to optimize portfolio allocation, maximize returns and minimize risks.²³¹ India established pension fund and the PFRDA in 2004 by which citizens aged 18–55 years can participate in a contributory pension scheme as an alternative to the provident fund. The Public Provident Fund (PPF) and the Employee's Provident Fund (EPF) are both funded substantially through tax savings. The author proposes that Bangladesh may adopt the regulatory theme of the New Pension Scheme (NPS), established by the Indian Government in 2010, which is now operational in 19 provinces and that the income of the fund is taxable.

²²⁸ Roderick B. Crane, Michael Heller and Paul J. Yakoboski (2008), 'Defined Contribution Pension Plans in the Public Sector: A Benchmark Analysis', Pension Research Council Working Paper, October, p. 56. The authors note that DC plans are designed to yield adequate retirement incomes, providing for the security of the fund and the shared responsibilities of employer and employee.

²²⁹ Hassan, S (2009) 'Current Issues for Retirement Benefit Schemes and Funds', 19 March, Karachi Sheraton, Pakistan.

²³⁰ Subhedar, S (2004) 'Pension Regulation Issues: A Framework for India', 6th Global Conference of Actuaries, New Delhi, 18-19 February <<http://www.actuariesindia.org>>.

²³¹ OECD (1998) 'Maintaining Prosperity in an Ageing Society', Paris Conference, OECD, 3 November <<http://www.oecd.org/subject/ageing>>.

Despite this, over 100,000 employees have joined the system and the 19 State governments have participated in a contributory pension system based on the NPS. Income tax rules in relation to tax exemption as described in s 80C of the Indian Income Tax Act 1961 provide guidelines on exemptions from tax for contributions to the EPF or the PPF, subject to an upper limit of Rs. 100,000. Contributions and accumulations in non-government provident funds through the NPS, superannuation funds and gratuity are exempt from income tax. The Indian government introduced the Direct Tax Code in 2009, which has changed income tax brackets and eliminated tax-free withdrawals from retirement plans.²³²

For the best part of a decade, the Indian government has negotiated various social security agreements with other countries.²³³ It has already signed agreements with Belgium, France, Germany, Switzerland, Luxembourg and the Netherlands. This type of agreement will strengthen bilateral relations and enhance social security in these countries. The agreement provides for portability of the pension benefits if and when workers have relocated in the signatory countries. Since 2001, India has been developing its pension market domestically by supporting insurance companies in providing pension products, including annuities and mutual funds. At the same time, other elements such as pension management, investment management and financial consultancy services are being developed to build a robust pension industry.²³⁴ All things considered, India is making significant progress towards a second pillar. As an OECD country, India has adopted the pension and provident funds reformation proposal of ADB with specific recommendations for regulating and supervising those schemes based on variations of the principles and standards for private and public pension funds. These schemes are related to the activities operated by the government's Working Party on Private Pension (WPPP) on governance, funding, investment regulations and financial education.²³⁵ India has furthermore undertaken a project that is known as the Old Age Social and Income Security (OASIS), which has been specifically set up to devise a pension system for India, and create awareness about the need to provide for income in old age. It has also initiated debate on the need to reform India's

²³² Shah, S and Mahajan, A (2009) 'India's Draft Taxes Code Bill 2009: Is the Mauritius Route Dead?' *Tax Notes International*, 5 October, 63.

²³³ Lahiri, A (2003), note 101.

²³⁴ Farrar, J (2005) *The Legal Core in Corporate Governance: Theories, Principles and Practice*. 2nd ed, Melbourne: Oxford University Press.

²³⁵ OECD/INPRS (2004) 'Reforming Pension System in South-East Asia', Third Manila Conference, OECD, 17 December <<http://www.oecd.org>>.

pension system.²³⁶ The OASIS project was the outcome of research undertaken in 2000 by the WB the ADB and the Colombo Plan Secretariat, all of which emphasised the need for pension reform in India.²³⁷

In 2000 the world's largest employee provident and pension fund in India introduced portable defined contribution schemes for new entrants, with government contributions matching the employee's contributions.²³⁸ It has also proposed covering companies with a minimum of 10 employees under the Employee Provident Fund and Miscellaneous Provisions Act 1952. For the benefit of employees, Indian legislation requires a provident pension fund to exist where a business has 20 or more employees. India wants to invest 100% of EPF funds in public sector instruments and in free markets so that pension investments receive higher returns.

In India many different schemes are operating and they can generally be grouped into three types: Social Safety Program, Mandatory and Voluntary Occupation Related Schemes. India has a scheme for Individual Voluntary Arrangements where around 12% of the population is covered by the formal pension system.²³⁹ In India the NPS is a voluntary pension scheme. Other voluntary schemes are also available and they are recognised as superannuation schemes. All public and private sector employees as well as self-employed people can participate in voluntary retirement plans that are offered by the government, such as the government-owned Life Insurance Corporation of India (LIC), private life insurance companies as well as mutual funds.

India still faces many social, financial and investment challenges. Its government is adopting international principles to reform existing pension schemes which still are very complex.²⁴⁰ India has no universal social security system. There are four types of social security system in relation to the civil service and military pension, statutory pension scheme and private sector provident fund schemes. Apart from this, there are voluntary savings schemes for self-employed people and unregistered workers. India has recently taken steps to target social assistance schemes and welfare funds for the poor.

²³⁶ Subhedar, S (2004), note 217.

²³⁷ Dev, Mahendra S (1999) 'Social Security in Unorganised Sector in India', Paper presented at the International Conference on Social Security Policy: Challenges before India and South Asia, 3 November, New Delhi.

²³⁸ Lahiri, A (2003), note 101.

²³⁹ Country Profile: India <<http://www.pfrda.org.in/indexmain.asp?linksid=56>.

²⁴⁰ Retirement In India: Pension benefits and beyond, *Dermiare mise Q Jour*: 19 May 2008.

However, the Indian pension and provident funds are being utilized by investment managers for their own corporate ends. Developments are occurring in India's corporate governance areas based on socio-economic principles and international law with respect to provident funds. It may be an example for Bangladesh's pension fund development in the future. The author has considered India because it borders Bangladesh and shares a similar legal, socio-economic and cultural history and traditions. Additionally, India is now a powerful player in the new global financial order and increasing its wealth.

5.4.2 INDIA'S PROVIDENT FUND SYSTEM

There are three schemes in India in the government sector. The EPF, the DC pension plans (both 12%) and gratuity benefits schemes are mandatory DB schemes. The supplementary superannuation scheme does not mandatorily depend on the DC or the DB formula, in which contributions are up to 15% of basic salary. The schemes are comprised of the Employees' Provident Fund (EPF) 1952, the Employees' Pension Scheme (EPS) 1995 and the Employees' Deposit Linked Insurance (EDLI) Scheme 1976.

The trustees of the superannuation schemes can either manage investments in the accumulation stage themselves or hand over the investment management to a life insurance company. Regardless of where the funds are managed, the income tax rules require that benefits be paid out as life annuities from insurance companies. Some companies are designing vesting scales that help with employees' retention so that they receive a higher vested portion of benefits if they remain in service for a longer period.

In 2004 the Indian government set up the PFRDA to supervise its pension fund. This PFRDA enables companies in India to provide attractive retirement benefits and differentiate themselves from their competitors.²⁴¹ India estimates that by 2015, pension assets under the NPS will be worth US\$ 175 billion. These will need to be intermediated through the financial and capital markets.²⁴² Consequently, reform of these markets and continuing improvements in corporate

²⁴¹ Anand, A (2006), 'India: Recent issues in retirement benefits markets', *Indian Times*, Mumbai, 13 January, Front page.

²⁴² Asher, Mukul G, and Nandy, A (2006), note 200.

governance will be the key to translating increased savings into economically productive and growth enhancing investments.

In conclusion it has been shown that India has made important steps in developing a co-contributory system that is open to non-government employees and people on low incomes. It has also taken the first steps towards establishing an independent regulator for the pension fund system that Bangladesh should consider.

5.4.3 HOW THE EMPLOYEES' PROVIDENT FUND SCHEME WORKS IN INDIA

The EPF is the fund where both employees' and employers' contributions are deposited in the provident fund account. According to s.6 of the EPF and the *Miscellaneous Provisions (MP) Act* of 1952, the employer has to deposit 10% of a total deposit of 20% payable to the provident fund account.²⁴³ The other (10%) contribution is deducted and deposited per month from the employee's basic wages, expense allowance and retaining allowance, assuming that it is payable to employees. The rate of contribution is 10% or less in certain cases. These requirements affect: any business or establishment with less than 20 employees; any establishments covered prior to 1997; and any sick industrial company as defined in Sub-Section (1) of Section 3 of the *Sick Industrial Companies (Special Provisions) Act*, 1985. The Board for Industrial and Financial Reconstruction also applies it to: any establishment which at the end of any financial year has accumulated losses equal to or exceeding its entire net worth; and any establishment engaged in manufacturing jute, bread, coir and guar gum industries or factories. The contributions by employee and employer to the EPF scheme by the employee and employer is made because of the establishment of the particular industry after 1997. In some other organizations employees have the option to make voluntary contributions to the EPF. It means that they may ask their employers to deduct an additional amount which is over the minimum 10%. The employee gets the fixed interest on the total accumulation and this interest is added to the total accumulation. In accordance with section 6C of the EPF and the 1952 *Miscellaneous Provisions (MP) Act*, the national government may organize a scheme for employees which are called the deposit-linked insurance scheme. This type of insurance scheme generally provides opportunities for life

²⁴³ Section 6 of the *Employees' Provident Fund and Miscellaneous Provisions Act* 1952 of India.

insurance. The insurance fund is also administered by the government in such a manner prescribed in the insurance scheme. Finally, the Indian EPF is transferable and portable in nature. Employees have the option to transfer the provident fund account if they switch jobs. The transfer of a provident fund account from one region to another - from an exempted provident fund trust to an unexempted provident fund in a region and vice-versa - can be done. The Provident Fund Office considers the merits of applying to transfer an account from one region to another.

5.4.4 LEGAL BASIS FOR INDIA'S EMPLOYEES' PROVIDENT FUND SCHEME

In this section, the author considers India's pension fund legislation in establishing provident funds for the private sector where a business has 20 or more workers. The *Indian Provident Funds Act, 1925* first introduced the compulsory deposit as a subscription or contribution to government or railway employees' provident funds through their individual accounts. It covers the whole of India except the States of Jammu and Kashmir. The EPF and the *MP Act, 1952* also provide the necessary directions and legislative authority for both employers and employees to contribute to the compulsory contributory provident fund. The *EPF Act* was modified in 1976 so that another social security called 'covered establishment' could be introduced. In accordance with this Act, the Indian government exercises the residual powers to any business which comprised 20 or more employees. The funds established under this Act are controlled by the central government, which also controls its regulatory functions by appointing trustees. This statute guides how the schemes, trustee framework and compliance requirements operate.²⁴⁴

The Employees' Provident Fund is administered by a Central Board of Trustees, comprising Indian government representatives and those from the provincial governments, employers and employees.²⁴⁵ The Board is chaired by the Union Labour Minister of India. The Chief Executive of the EPFO, the Central Provident Fund Commissioner, reports to the Union Labour Minister through the Permanent Secretary in the ministry. The head office of the organisation is in New Delhi. Through the auspices of the *Public Provident Fund Act, 1968*, the Indian government has framed a pension fund scheme for the general public. Any individual may, on his or her own

²⁴⁴ The Indian Law search <<http://www.epfochennai.tn.nic.in>>.

²⁴⁵ Section 5A and s. 5B of the *Employees' Provident Fund and Miscellaneous Provisions Act 1952* of India.

behalf or on behalf of a minor, of whom he is the guardian, subscribe to the fund in such a manner and subject to such maximum and minimum limits as may be specified in the scheme. This scheme must be laid before the Parliament of India for approval.²⁴⁶

Like Singapore, India provides a salient lesson on how Bangladesh might extend the contributory provident funds to all of the private sector. The legal frameworks of Singapore and India provide possible opportunities for the government of Bangladesh in marshalling the country's national savings and distributing rates of return to participating fund members in a future universally accessible pension fund.

5.4.5 INDIA'S CURRENT PENSION REGULATORY FRAMEWORK

A consideration of India's regulatory system provides lessons for Bangladesh to start a universally accessible pension fund within a regulatory and corporate framework. India has taken strong steps towards establishing a three-pillar system. In particular, for the purposes of a constructive comparison with Bangladesh, India now offers tax incentives to encourage contributions to its fund. It provides a separate trust fund although it remains a fund supervised by the government, and it has established a portable fund for workers. At the same time, however, there remains much work to be done. The current regulatory framework for pensions in India remains essentially government controlled and is not regulated by an independent authority. The critical features of the tax incentives and tax office regulations concerning all funds in India are outlined below:

- a) The government provides tax concessions to employees when they make contributions to their individual pension funds. The DB pensions of government employees who started work before 1st January 2004 are not funded and are paid on a PAYG basis out of the current revenue. The PAYG system is managed by the government and as such is not supervised by any regulatory authority. A similar DC pension in the form of a fully funded individual account pension requires a regulatory framework supervised by the PFRDA. The PPF is managed by the government with 75 per cent of the net accretions

²⁴⁶ Section 12 of the *Public Provident Fund Act* 1968 of India.

being given as loans to the state (i.e. central government and provincial governments) and balance credited to the government's public account. As such it does not require supervision by a regulatory authority. Furthermore, this fund is most likely to be closed to the individual account pension system.

- b) The EPF is administered, regulated and supervised by the Employees' Provident Fund Organisation (EPFO). This is not a very satisfactory arrangement since the body that administers it also regulates and supervises it. It should be separated from the jurisdiction of the EPFO. The EPS is also administered and regulated and supervised by the EPFO. In 2004 India has attempted to separate the regulatory and supervisory functions from the EPFO.
- c) The occupational pensions fund in India was established with approvals by the Commissioners of Income Tax (CITs) under the provisions of Part B of the Fourth Schedule of the *Income Tax Act*, 1961. It envisages the proper supervision of the fund by the relevant CITs although this supervision remains confined only to ensuring adherence to the prescribed investment pattern. The other aspects of supervision are left to self-regulation through auditors and actuaries and any self-regulation, to be effective, must have the legislative framework. In India there are no minimum funding requirements. As in the case of occupational pensions, the gratuity funds are set up through approvals from the CITs under Part C of the Fourth Schedule of the *Income Tax Act*, 1961. It is also supervised by the CITs. This pension scheme is actually a defined benefit scheme that combines personal pensions and group pension products offered by the life insurers. They are regulated and supervised by the IRDA and those offered by the MFs are also regulated and supervised by the SEBI.

It might be seen from this review that India is well advanced in offering tax incentives to contributors to these funds. Bangladesh might consider the way in which this has been done in formulating its own tax incentives. However, within the Indian regime there has been no separation of the administrative and regulatory roles expected of the taxation office and this is a matter of potential concern. In this respect Bangladesh would ideally wish to lay the foundations for an independent regulator within a three-pillar system.

5.5 THE SUPERANNUATION SYSTEM IN AUSTRALIA: AN ESTABLISHED 'THREE-PILLAR' MODEL

5.5.1 FEATURES OF THE AUSTRALIAN SYSTEM

In contrast to India, Australia has a well developed pension fund system which operates within a well regulated financial system and a politically stable environment. Yet a developed system like this may not be applicable in Bangladesh. Nevertheless, the author has considered the Australian pension fund system as a benchmark because it is well governed by the legislation, has industry regulations, and high levels of funds within a corporate and trustee framework and direct investment system. In Australia, the pension fund is called as superannuation fund developed within a legal framework built from rules derived from the common law of trusts, and rules imposed by taxation law.²⁴⁷

Australia's superannuation model comprises government-funded pensions, compulsory contributory superannuation savings and voluntary superannuation savings, which are known collectively as the "Three pillars" of superannuation.²⁴⁸ The superannuation model is intended to partially shift the burden of the aging population away from government and onto individuals, with the emphasis on self-funded retirement rather than public pension arrangements.²⁴⁹ Australian governments will also benefit from the taxation revenue that is collected from superannuation savings.

In the Australian superannuation system, the first pillar is a type of safety net that provides social security retirement benefits that are not conditional upon past employment.²⁵⁰ The second pillar is made up of often compulsory, employment-related superannuation contributions, which are accumulated during a retiree's working life. Under this system, a minimum level of employer contribution must be paid on behalf of all employees. The third pillar comprises voluntary

²⁴⁷ Jones, S (2008-09), 'Australian Superannuation Handbook', Thomson Reuters, Sydney Australia, p. 37.

²⁴⁸ Knox, D M (1996) 'Contemporary Issues in the Ongoing Reform of the Australian Retirement Income System' 114 *Australian Economic Review* 199, OECD (1998) 'Maintaining Prosperity in an Ageing Society', Paris Conference, OECD, 3 November <http://www.oecd.org/subject/ageing> and World Bank (1994) *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth*. Oxford: Oxford University Press.

²⁴⁹ Cortese, C and Glynn, J (2006) *Taxation and Australia Superannuation System: An Introduction Compression*, NSW: University of Wollongong.

²⁵⁰ Bateman, H and Piggott, J (1997) 'Private Pension in OECD Countries', Australia: OECD Occasional Paper, 20 August <<http://www.afaanz.com>>, and Glenn, B (2006) *Developing an Approach to Pension Reform*, Asia-Pacific Region PSI, 12 February <<http://www.world.psi.org>>.

retirement savings contributed to a superannuation or pension fund. Here employees may elect to sacrifice a portion of their pre-tax salary as voluntary superannuation savings.²⁵¹

The Australian superannuation system has made important developments since 1992 and currently over 90% employees participate in it. It comprises private retirement savings which is mandated by the superannuation guarantee. This guarantee is a compulsory, contributory superannuation savings scheme. Superannuation benefits may be taken as a lump sum, a pension, or a combination of the two. The federal government made sweeping legislative changes to the superannuation system in 2007. These changes aimed at simplifying and streamlining the superannuation system. It resolves some tax complexities, enhances retirement incomes and provides greater flexibility.

The Superannuation Industry Supervision Act defines a self-managed superannuation fund. This type of fund does have some criteria such this kind of fund must have no more than four members, all members of the fund are trustees, no member of the fund is an employee of another member of the fund, unless these members are related and no trustee of the fund receives any remuneration for this service as a trustee. A self-managed fund can also have a company as a trustee (known as a corporate trustee), provided the company meets certain criteria. If the trustee of the fund is a body corporate, each director of the body corporate is a member. A superannuation fund with only one member can be a self-managed superannuation fund if it satisfies several other conditions. Finally, it is noted that superannuation in Australia is a specifically designed long-term investment vehicle for individuals' retirement savings. Australians have a fundamental right to determine where superannuation contributions made on their behalf are paid.²⁵²

5.5.2 CHAPTER 5C OF THE CORPORATIONS ACT 2001 – A COMPARISON

Mutual funds in Bangladesh may lead to the regulation of managed investments and provision of investor protection for investors in such funds. People will contribute money in order to acquire rights (interests) to benefits produced by the scheme. Here the investor has no day-to-day control

²⁵¹ Barrett, J and Chapman, K (2000), *The Australian Superannuation System*, Australian Prudential Regulation Authority (APRA), 1–11.

²⁵² ATR (Australian Treasury Report) (2001) 'Better Superannuation System', 2 July <<http://www.treasury.gov.au>>.

over the use of the money to generate the return. It may be in the form of common investments. A trustee is appointed to hold and manage the money on behalf of the investors and invest the money for their benefit. It is a time-sharing scheme.

5.5.3 PENSION DEVELOPMENTS IN AUSTRALIA

In Australia it is very simple to start a superannuation fund. People can compare fees, charges, investment options, insurance covers, etc. Australia's system provides a tax-advantaged method of saving in that the 15% tax rate applies to contribution.²⁵³ The practice of trusts has been a traditional part of the Australian superannuation system. Superannuation funds are mainly structured as expressed trust. The trust instrument and governing rules protect the rights of both the trustees and members. Trustees are responsible for the prudential operation of the superannuation funds.²⁵⁴ The investment manager is under obligation to apply prudent formula, implementation of policy and investment strategy.²⁵⁵ Trustees are legally liable if they commit any breach of duties and obligations. Superannuation trustees are obliged to make sure that the super fund is invested wisely and prudently with consideration of diversification and monetary interest.²⁵⁶

In Australia an employee contributes at least 9% of his or her salary.²⁵⁷ The superannuation fund then makes investments on behalf of the employees to accumulate their retirement savings. There are different superannuation fund industries and various options have been provided for investments and insurance cover. Employees may receive the basic pension from the government, but there are different rules for the complementary scheme so that Australian private sector workers are not covered exclusively by defined contribution plans, the Australian Commonwealth Government Retirement Scheme and some states' schemes involving hybrid arrangements.²⁵⁸ The Australian federal government ensures its constitutional responsibility for

²⁵³ Encyclopaedia of Superannuation in Australia, Wikipedia, <<http://www.en.wikipedia.org>>.

²⁵⁴ *Superannuation Industry (Supervision) Act 1993* & other obligations are subject to General Trust Law of Australia, <<http://www.lexisnexis.com.au>>.

²⁵⁵ *Superannuation Industry (Supervision) Act 1993(SIS) Act of Australia*, <<http://www.lexisnexis.com.au>>.

²⁵⁶ Regulated by Australian Prudential Regulation Authority (APRA) and Australian Security and Investment Commission (ASIC).

²⁵⁷ *Superannuation Guarantee (Administration) Act 1992* (Australia), <<http://www.lexisnexis.com.au>>.

²⁵⁸ OECD/INPRS (2004), 'Reforming Pension System in South-East Asia', Third Manila Conference, OECD, 17 December <<http://www.oecd.org>>.

legislating on superannuation matters.²⁵⁹ The federal government's Superannuation Guarantee Scheme requires all employers in Australia to make a prescribed level of contribution to a complying superannuation fund on behalf of their employees.²⁶⁰

Employees' legal rights or access to legal avenues have been secured here in accordance with the laws of the land and their relevant regulations. Employees can bring complaints against their trustee in relation to their superannuation at a tribunal specially made for resolving such complaints.²⁶¹ Legal arrangements in the superannuation industry do protect an employee's superannuation funds. Nationally Australia now has a sizable savings that can be invested in the capital market and international markets.

5.5.4 THE SUPERANNUATION INDUSTRY (SUPERVISION) ACT 1993 (THE SIS ACT)

The *SIS Act* governs the superannuation funds of Australia. This statute effectively requires that all superannuation entities conduct their operations using a trust structure. Under a trust structure the trustee has legal ownership of the funds contributed. Subject to the terms of trust deed, the trustee has the right to invest those funds at its discretion for the ultimate benefit of the beneficiary subject in trust law to the duties of the prudent investor. The APRA confirms this type of investment practice in the superannuation industry.²⁶²

5.5.5 THE DUTIES OF THE TRUSTEE UNDER THE SIS ACT

The trustee must deal prudently with the funds on behalf of the beneficiary and in the best interests of that beneficiary. The trustee is personally liable for losses incurred in relation to unauthorized or "imprudent" investments. Sec. 52(2) (f) of the *SIS Act* of Australia raises a complex legal issue which concerns the duty in trust law that might be expected of a large modern superannuation trustee responsible for the investment of very large funds. Generally, this duty is said to be satisfied if the trustee invests in a wide range of asset classes – but is this any

²⁵⁹ Legislative powers of the Parliament, S.51 (xxiii) of Australia's Constitution "The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to....."

²⁶⁰ *Superannuation Industry (Supervision) Act 1993 (SIS)* (Australia), <<http://www.lexisnexis.com.au>>.

²⁶¹ *Superannuation Regulations of Complaints Act 1993*, <<http://www.lexisnexis.com.au>>.

²⁶² APRA (Australian Prudential Regulation Authority) (2009) 'Superannuation Fund-Level Rates of Return' 12 August <<http://www.apra.gov.au>>.

longer a wholly satisfactory foundation for the trustee's duty? It is still a burning legal issue and this model remains imperfect. This issue also exists in the UK and the USA and has been never really been resolved. There are so many factors involved when considering a trustee's prudential investment capacity. If the trustee and the investment manager jointly satisfy the requirements of market research and investment strategy within the ethical and regulatory dimensions, subsequently the risk of personal liabilities of a trustee might be reduced.

The trustee is required by the above section of the *SIS Act* to articulate an investment plan and strategy that in all the circumstances of the plan takes into account and includes risk against return, investment objectives, cash flow needs and diversification of investments. If the trustee properly formulates and implements such a strategy then the *SIS Act* protects trustees from civil action for loss or damage as stated in section 52 (2) (f) of the *SIS Act*.²⁶³

Investment limits are unnecessary for industrialised countries such as Australia, which have well-established financial markets and sophisticated supervisory agencies. The 'prudent man' rule and fiduciary diligence should suffice to ensure adequate diversification and custodial protection of pension fund assets. In developing countries, however, initially tight and detailed investment rules are justified by the absence of strong transparent capital markets, the compulsory nature of the pension system, and the pension fund members' lack of fiduciary with capital market investments. These rules should be systematically relaxed as domestic capital markets grow and mature.²⁶⁴

In the long-term, the author also suggests the more significant value of large public and private pension fund trustees in the UK and the USA which have utilized their voting rights and position as major shareholders to promote better governance and corporate performance in the companies in which they invest. In this respect, the pension fund trustees represent the collective private and public interests of their employee members and provide an important voice in corporate management, regulation and social responsibility.²⁶⁵ As a corporate shareholder, the portfolio

²⁶³ Hoser, T, Hezell, K and Waldron, D (2002) 'Australia: Some Legal Issues Relating to Superannuation Trustees as Hedge Fund Investors', December edition, 19 *AIMA Journal*.

²⁶⁴ World Bank (2006), note 12.

²⁶⁵ Romano, R (1993), 'Public Fund Activism in Corporate Governance Reconsidered', *Columbia Law Review*, Vol. 93, 795-853.

investments of large pension funds also play a significantly passive role in stabilizing the financial markets.²⁶⁶

In recent years the large public pension funds have exercised their voting power in corporate matters.²⁶⁷ This more active role of pension funds in corporate governance is also likely to become an important issue in countries with mandatory but decentralized pension systems, such as Chile and other Latin American countries. The collective voice approach being developed in the UK and the USA, as well as in Canada, Australia and other countries, also seems to be appropriate for developing countries. This approach to corporate governance through the exercise of voting rights by pension funds might help reinforce corporate governance and regulation of listed corporations. In this respect Bangladesh may enable its citizens and investing institutions to participate in developing a sound corporate policy and adopt international principles and practices. These constitute an alternative to individual investor share ownership and the potential assumption of corporate liability.²⁶⁸

5.6 RELEVANT CONSIDERATIONS FOR BANGLADESH EMERGING FROM THESE COMPARISONS

In the following sections the author considers three aspects emerging from a comparison with other jurisdictions: growing the fund, providing a suitable tax incentive foundation and positioning the pension fund system within or alongside the welfare system.

5.6.1 GROWING THE PENSION FUND

This section considers the pension and provident funds of the reviewed countries and how they may help Bangladesh decide on its future course. The world is familiar with the phenomenal growth of pension funds and their potential value as major shareholdings.²⁶⁹ We can see that the accumulation of funds or savings in various pension and provident schemes have an important

²⁶⁶ Chandler, AD Jr, (1977), 'The Managerial Revolution in American Business', *The visible Hand*, Cambridge Mass, Belknap Press ; and Jensen MC and Meckling Wh (1976), *Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure*, *Journal of Financial Economics* 305-360.

²⁶⁷ Larcker, D, Richardson, S and Tuna, I (2004) *How Important is Corporate Governance*. USA: Wharton School, University of Pennsylvania.

²⁶⁸ Gilson, RJ (2006), 'Controlling shareholder structures and corporate governance: complicating the comparative taxonomy', *Harvard Law Review*, Vol 119, at 1641. In 2006 in the United States of America, Ronald Gilson is drawing attention, once again, to the 'relative simplicity' of the comparative taxonomy of 'controlling shareholder structures' and to the need for a 'deeper understanding of the diversity of ownership structure in different national capital markets and their policy implications'.

²⁶⁹ Nicoll, G (2006), note 53.

influence on the evolution of corporate governance, which has increased internationally. The pension fund has greatly augmented the major capital markets in Australia, UK, USA and Europe.²⁷⁰ This fund attracts institutional investors who consider it to be an international source of equity capital.²⁷¹

By building up the domestic securities markets to an adequate position with enough liquidity and transparency the pension assets may a satisfactory level of total GDP and subsequently the market capitalisation of all the assets grows. It is noted that liquidity is an important factor for reducing the costs of transactions, and for getting the best return on an investment. Transparency is important, particularly for countries that have poor governance practices in the corporate sector. The individual as a beneficiary may get a greater incentive or returns by monitoring the financial performance of the investment corporation in which he or she invests pension funds. The countries that suffer from non-transparent market issues should adopt international corporate principles to improve this situation. These principles are equally required for a government employee funded system, private funds, corporate finance system, equity and bonds markets. Adherence to international corporate and investment principles are important when DB and DC funds are being invested. It will ensure transparency and freedom of investment choice.²⁷²

5.6.2 TAX APPROVED TRUST FUNDS

In Bangladesh the provident funds are mostly DC pension schemes, in the form of tax approved trust funds. The employee can contribute up to 10% of his or her basic salary (range 8%-10%). Government employees receive 12.5% interest (p/a) on the total amount of their provident fund at the end of each financial year. The law does not impose any provision on government employers to contribute to their employees' provident fund. As a result, the fund accumulated for the individual employee is limited to the contributions made plus 12.5% if that interest is compounded. However, the great flaw lies in the fact that there is no incentive given in the form of a tax reduction on member contributions that would encourage individual members to make such contributions. All of the different systems reviewed above have adopted these incentives.

²⁷⁰ Mitchell, S and Husted, E (2000) *Pension in the Public Sector*. Philadelphia: University of Pennsylvania Press.

²⁷¹ Nicoll, G (1997), note 56.

²⁷² Larcker, D, Richardson, S and Tuna, I (2004), note 255.

Without such incentives it is difficult to establish the pension fund and continue to convince members that they might accumulate sufficient funds on which to retire comfortably. In addition, more autonomous public organisations and the defence forces have set up provident funds that provide for employers matching employee contributions. In contrast to the Chilean model, which advocated taking away the PFs completely from government control so that they could be managed by smaller fund managers and strictly supervised by the government with proper guidelines, if the Bangladeshi government retains control then there PF contributors will have only limited ability to compare market operations nationally and internationally.

In Bangladesh the gratuity schemes are very similar to DB pension schemes, and the gratuity is defined in terms of last drawn basic or gross salary. This is the legal position which imposes a statutory gratuity under the standing orders of the Government. It states that every industrial or commercial establishment in which 20 or more “workmen” are employed must, if the “standing orders” apply to it, pay a gratuity of 30 days’ last drawn gross wages for each year served on the cessation of a “workman’s” service. In reality, this order does not apply to all employers. However, in practice, we can see that if the Provident Fund facilities exist, to which the employer's contributions are equally made to employees, no gratuity applies to the time period for which the Provident Fund has existed. Under the non-statutory gratuity schemes there are many employers who have set up gratuity schemes outside the scope of the standing orders. These apply to employees who are not working under the coverage of standing orders. They may also apply to an employee who receives a Provident Fund, but for whom the employer has in addition provided a gratuity, either voluntarily or as a result of mutual agreement.

The major concern with this arrangement is that there is no legal requirement to fund a gratuity scheme. As a consequence there are many schemes in Bangladesh which remain un-funded. According to Suzan Thomas,²⁷³ the typical feature of pension systems in South Asian countries including Bangladesh is that they are antiquated, and the DB schemes or the DC schemes of the pension and provident funds which are still unfunded and controlled by the relevant employers. There is no tax incentive provision in relation to voluntary contribution to the funds. This system is comprised of a public sector regulation of a pension fund, public management or employer-

²⁷³ Thomas, S (1998) "Performance Evaluation of Indian Funds", Tata McGraw-Hill, Chapter 4 of the *Investment of Indian Funds*. <<http://www.igidr.ac.in>>.

controlled and non-transparency of the funds under management and finally the lack of knowledge about regulation of financial markets.²⁷⁴ The author argues that tax concessions may attract the target socio-economic groups with the means to contribute to the national pension fund.

5.6.3 THE PENSION FUND AS PART OF THE WELFARE POLICY OF BANGLADESH

In Bangladesh the ageing population has become an important social concern. There is no well established social security system.²⁷⁵ As a developing country Bangladesh is attempting to establish one but in of the size of population, scarcity of resources, existing poverty, insufficient healthcare facilities and absence of social security, ageing will continue to be a major problem. The government has introduced pensions, gratuities, group insurance, and benevolent funds for retired government officials and their dependents. Retired persons or their dependents will not have to depend on others for their survival.

The constitution of Bangladesh ensures all rights and privileges of the elderly people. Article 15 of the constitution of Bangladesh speaks clearly on this issue, which is as follows: ‘it shall be a fundamental responsibility of the state to attain, through planned economic growth, a constant increase of productive forces and a steady improvement in the material and cultural standard of living of the people, with a view to securing to its citizens. The provision of the basic necessities of life are articulated as follows:

(d) The right to social security, that is to say, to public assistance in cases of underserved want arising from unemployment, illness or disablement, or suffered by widows or orphans or in old age, or in other such cases.

In 2006 the Ministry of Social Welfare finalised its National Policy on Ageing. The government is trying to expand social security benefits over the whole nation on the basis of people’s physical, economic and social conditions. The government has taken some positive schemes to implement its plan. This policy is formulated on the line of the Madrid International Plan of

²⁷⁴ IMF (2010) ‘Bangladesh: Selected Issues of Market-Sensitive Information’, *Contribution to the World Summit on Social Development*. Washington: IMF.

²⁷⁵ IMF (2007) ‘Bangladesh: Selected Issues’, International Monetary Fund Country Report, 23 February, No. 02/114, Washington: IMF.

Action on Ageing. The main objective of this policy is to ensure social security, healthcare, employment and rehabilitation. The government has initiated micro-credit strategies to reduce poverty throughout the country. This micro-credit is free of interest and collateral.²⁷⁶

The age allowance program was introduced in Bangladesh in 1998. Under this program the poor and distressed old-age people are financially supported. The government spends less than 1% of GDP and about 4.4% of public expenditure on social safety net programs. The pension is really only an opportunity for government employees in Bangladesh.²⁷⁷ Although the pension fund is a complex issue in any welfare system but it is thought to be a productive investment formula.²⁷⁸ Pension funds have evolved from representing informal, intra-family investment in human capital, i.e. the labour force, to working-age people who typically are required to pay into a system designed to fund the retirement of preceding generations. Pension funds are also mandated to pay out benefits in an orderly and fiduciary sound manner. Consequently, pension system administrators are trying to find and incorporate innovative financial instruments to help them fulfill their fiduciary responsibility of providing adequate benefits and reducing liabilities.²⁷⁹

Pension administrators increasingly emphasise the importance of fully funding pension liabilities. Full funding has the effect of making a pension plan's debt explicit, which in turn helps diminish any prospect of default. Properly working legal and regulatory systems are vital to the success of the pension fund reform process and it also requires a well-developed political, economic, and institutional investment. There must be enough domestic demand to explore to the possibility of generating funds to be used on the national and international markets. To become a global investor Bangladesh needs to adopt international principles to reform or amend its current provident fund system.

Currently, the world faces a common challenge in trying to increase capital in pension funds for social security programs so that they can be managed effectively. The pension fund is considered to be an important aspect of the overall risk profile assumed in this process. Better pension fund

²⁷⁶Wali, M (2006), *Microcredit and Micro-entrepreneurship*, 2nd ed., Dhaka: Academic Press and Publishers Limited (APPL). "Microcredit operation is intimately related to the concepts of microfinance, poverty alleviation and micro entrepreneurship. A system of credit delivery and savings mobilizing scheme especially designed to meet the unique financial requirement of the poor".

²⁷⁷ Hassan, M (2007), note 44.

²⁷⁸ Larcker, D, Richardson, S and Tuna, I (2004), note 255.

²⁷⁹ Farrar, J (2005) *The Legal Core in Corporate Governance: Theories, Principles and Practice*. 2nd ed, Melbourne: Oxford University Press.

practices support improved domestic economic progress, national savings, investment and corporate governance. In these ways fund beneficiaries will have more options to make money. The trustee and the fund manager both play important roles in expanding the regime of trust in corporate management. Pension funds such as the DB and DC schemes or hybrid versions of two both are contributing to more finance being available in the financial market. In Bangladesh, the lack of a proper regulatory framework and guidance for corporate investment of pension funds is restricting the opportunity for Bangladeshi citizens to benefit from investments in international financial markets, where the rate of return might be higher than the fixed interest paid by the government in a pay-as-you-go pension system.²⁸⁰

5.7 STRUCTURAL CHANGES SUGGESTED BY THE COMPARISONS

It is true that changing a pension fund system is a very complex and challenging task. However, in its current circumstances Bangladesh needs to design a framework for a system that will work in the future. In 2004, the ADB provided technical assistance to initiate pension reform in India. The ADB approved a one million dollar credit to India to improve its private and public provident fund system.²⁸¹ India has modified its pension funds system with the co-operation of the ADB and WB.²⁸² These two international organisations now want to reform the Bangladeshi insurance, pension and provident funds systems.²⁸³ If the Bangladeshi equity markets are able to utilise pension contributions by offering various schemes to beneficiaries they may provide an effective platform for economic growth as well as providing for citizens' happiness in their old age.²⁸⁴

Such reforms in Bangladesh should be carefully crafted and sequenced. The government must employ an integrated approach because it will be a very politically sensitive issue.²⁸⁵ There is symbiotic relationship between pension schemes and capital markets, so Bangladesh needs to

²⁸⁰ Blair, MM (1995) *Ownership and Control-Rethinking Corporate Governance for the Twenty-First Century*, Washington: The Brookings Institution.

²⁸¹ Asian Development Bank (ADB) (2000) 'Reformation of Pension and Provident Funds of Bangladesh', Asian Development Bank's Report, Technical Assistant Documents Database, World Bank. <<http://www.worldbank.org>>.

²⁸² TA 4548-IND (2004) 'Indian Pension and Provident Funds', Technical Assistance Performance Audit Report, Asian Development Bank, 5 April <<http://www.adb.org>>.

²⁸³ World Bank (2008) 'An Assessment of Social Safety Nets in Bangladesh'. WB Group: Washington, D.C., 15 November <<http://www.publications.worldbank.org/ecommerce/>>.

²⁸⁴ Ali PU, Stapledon, G and Gold, M (2003) *Corporate Governance and Investment Fiduciaries*, Sydney: Lawbook Co.

²⁸⁵ Asher, Mukul G, and Nandy, A (2006), Note.200

develop a set of sound policies that mutually reinforce each other. At the same time tax compliance, design of pension schemes, investments plans, serving participants, role of technology, of the varied roles of government, employees and employers, have to be considered when recreating an entire pension system. The provident and pension funds at present are not helping in the development of capital markets.²⁸⁶ The regulatory weakness has been mentioned as a fundamental cause of the low coverage of pension schemes, institutional weakness, and mass poverty. The legal framework for pension schemes is very complex.

Bangladesh has a strong workforce that can potentially participate in pension plans and fund development. If the procedures for operating pension schemes are clarified within a short time, Bangladesh can provide a leading international example. Innovative private sector participation is necessary to develop pension reforms as a priority. In 2008 the report published by Transparency International Bangladesh (TBI) stated that the public pension is one of those sectors where corruption is high and 71% of pension receivers had to pay a bribe to receive their pension payment order (PPO).²⁸⁷ The Chairman of the TBI Trustee Board said that the government should amend the existing pension policy to acknowledge the benefit as a right that retired civil servants are entitled to, not simply a benevolence. The government should keep providing for each official and employee during their whole service period and amounts should be put into a separate fund. He added that many countries and international agencies follow this system.²⁸⁸

Bangladesh pays pension money to retired employees from the national budget which is unfair because the budget is generated from taxes and other revenues. It creates a burden for future generations. On the other hand, developed countries provide pension benefits to employees or citizens which are generated through pension fund investments. Comparatively, the returns on the investment of pension funds are higher than the 12.5% fixed interest rate on the contribution made to the Bangladeshi provident fund. Bangladesh needs to set up an integrated approach to

²⁸⁶ Financial Sector Assessment Program (FSAP) (2009) 'Program for Financial Assessment of Bangladesh' IMF and World Bank. 25 January <<http://www.imf.org>>.

²⁸⁷ Staff Correspondent (2008), 'Pay Bribe, Get Pension', *The Daily Star*, 26 August, 1.

²⁸⁸ Staff Correspondent (2008), 'Future Pension Policy for Bangladesh', *The Independent*, BSS, Dhaka, Jatiya Press Club.

social protection by fostering coordination between agencies administering social assistance programs and creating uniform targeting mechanisms.²⁸⁹

International aid agencies such as the ADB, WB and IMF emphasise the reformation of the Security and Exchange Commission and Bangladesh Stock Exchange, the strengthening of the Privatisation Board and the insurance and pension and provident funds of all Asian countries, not just Bangladesh. The ADB has recognised the fact that reforming pension systems in developing countries will help develop capital markets and in turn improve economic growth and industrial expansion.²⁹⁰ Most of the countries reviewed above have adopted the international principles of pension industry recommended by the International Organisation of Pension Supervisors.²⁹¹

5.8 CONCLUSION

A comparison of different countries' pension fund jurisdictions suggests the importance of investment and management of these funds for establishing and growing them. Tax incentives are important for contributions and the fund should be situated within or alongside the welfare system.

In considering the primary comparisons with Australia and India, the author concludes that while Australia might provide a benchmark model for a developed Western country operating the 'three-pillar' system, Bangladesh's history and administrative/ regulatory regime is more similar to that of India. An appreciation of this history and context suggests that incremental rather than wholesale administrative and practice changes, may be more desirable for success in the longer term. The significance of international corporate governance in pension funds is now a well-documented practice for long-term capital investment. It helps to achieve a superior investment

²⁸⁹ World Bank (2008) 'An Assessment of Social Safety Nets in Bangladesh'. WB Group: Washington D.C., 15 November <<http://www.publications.worldbank.org/ecommerce/>>.

²⁹⁰ OECD (Organisation for Economic Cooperation and Development) (1994) 'Bangladeshi Pension System', World Bank Conference, OECD, 9 November. <<http://www.oecd.org>>.

²⁹¹ IOPS (International Organisation of Pension Supervisors) (2006) 'Principles of Private Pension Supervision'. Turkey: International Organisation of Pension Supervisors.

return. Most countries now promote pension funds as a form of corporate capital under the corporate law and governance even developing countries are in time to rethink about it.²⁹²

In Bangladesh, unlike India, the pension fund is developing separately from the welfare system, although it is obviously a vital component of the three-pillar system. In India, the provident fund may be growing to effectively meet the needs of a non-existent welfare system. In other countries too, it appears that the same decision is being made where a modern pension fund system is preferable to a government-administered welfare system. India's experience may now show the way for Bangladesh. India operates a co-contributory system and extends the provident fund to non-government employees and people on low incomes. Bangladesh should carefully investigate these incremental developments and consider adopting them. However, India has not gone so far as to adopt an independent trustee. The question for the Bangladeshi government is whether it might take this additional step.

²⁹² Mitchell, S and Twinney, M (1997), *Positioning Pensions for the Twenty-first Century*. USA, University of Pennsylvania Press. The authors pointed out that in regard to "commercial reprisal" for private funds trustee and "political reprisal" for public fiduciary, this issue can only be solved by the government retaining responsibility for pension funds.

CHAPTER 6: DEVELOPING NASCENT INSTITUTIONS WITH TRUST LAW IN BANGLADESH

6.1 INTRODUCTION

In Chapter 3 it was noted that the WB found weaknesses in nascent financial institutions in Bangladesh. These weaknesses were described in Chapter 4 as being attributable to an old and outdated trust law. In Chapter 5, trust law was seen to provide the foundation for a three-pillar pension fund system in developed countries such as Australia. In this chapter, the author examines the ways in which trust law might be developed and utilised most effectively in Bangladesh to advance the pension fund system in the private sector.

It is argued here that Bangladesh must develop its trust law, and the concept of an independent, regulated trustee of pension funds. The reason why the author considers an independent trustee is so important in Bangladesh is the need to separate the administration, regulation and investment of the fund from government control. Although the most obvious first step may be to follow India's lead, since India utilises the same law as Bangladesh, the author argues that Bangladesh should consider a separate and independent pension fund trustee and the adoption of broader independent regulation (see Chapter 7).²⁹³

Referring to the Indian and Australian models, the author argues in this chapter that certain key features of trust law need to be considered for nascent trust law in Bangladesh. These features include the unfettered powers of the trustee; the trustee avoiding conflicts of interest; the trustee's fiduciary obligation to beneficiaries; and the maintenance of a separate trust fund. Additionally, Bangladesh should consider the more contentious question of extended investment powers to enable provident funds and specialist investment funds to improve their returns to members, possibly through investments on world markets.

²⁹³ Asher, Mukul G, and Nandy, A (2006), note 200.

6.1.1 THE IMPORTANCE OF TRUST LAW

Here the essential features of trust law and extension of trustee powers of investment are discussed. The author's suggestion is that the Bangladesh government utilise its accumulated experience of administering the Provident Fund and appoint an independent trustee. This trustee should have three main objectives in mind: firstly, loosening the present restrictions on the investment of the provident fund; secondly, attracting a more general membership to the fund (i.e. not just government employees); and thirdly, devising a taxation and regulatory system to supervise these developments.

In Bangladesh, trust law is vital for national savings to be marshaled for investment through the adoption of the legal form of a trust, and utilising the wider framework of trust law to provide a transparent pension fund.²⁹⁴ When satisfied that this is a transparent trustee and trust framework, it is more likely that Bangladeshi citizens will invest in pension funds. Fund members will be beneficiaries of the trust with the trustee corporation being the legal owner of the fund.²⁹⁵ In this way a nascent institution will provide a safeguard for any funds coming under the trust law and regulations will enable people to exercise personal trust in pension and provident funds investment. Here, Australian law and practice is referred to in order to provide examples of how the Bangladeshi system might be extended and developed. The author draws also draws on the lessons learnt from India.

Although the *Trusts Act*, 1882 of Bangladesh was reviewed in 2000 its structure and wording were no longer relevant to commercial activities. There is no particular provision for unit trusts as vehicles for collective investment schemes, as there is in Australia, for example. The trust structure in Bangladesh should be used more commercially by banks as a legal foundation for provident and pension fund schemes and for investments such as unit trusts and corporate custodian trusts.²⁹⁶ The unit trust structure allows the investment in commercial assets to be managed by one entity while being owned by another, a system whereby the investments into

²⁹⁴ Sin, K.F (1997), *The Nature of the Unit Trust*, Clarendon, Oxford, at p. 102.

²⁹⁵ Hill, G (2002), 'The True Nature of a Member's Interest in a Superannuation Fund', *Journal of Australian Taxation*, Vol. 5

²⁹⁶ Austin, RP (1989), 'The Role and Responsibilities of Trustees in Pension Plan Trusts: Some Problems in Trust Law in TG Youdan (ed), *Equity, Fiduciaries and Trust*, Ontario: The Carwell Co. Ltd.

assets owned by the unit trust can be traded for money through the allocation of units. Trust should allow a flexible government tax policy to be developed.²⁹⁷

The *Trusts Act*, 1882 should have five major uses for the trust device, these being estate planning, charitable gifts, pension trusts, business trusts and trusts for the creation and enforcement of security interests.²⁹⁸ A trust should be distinguished from an agency with an independent trustee and a trustee possessing wider statutory power of investment. The trustee should be directed by the trust instrument in making decisions; not by a settler as a principal. The flexibility and a wider understanding of the modern trust concept will enable the Bangladeshi Trusts Act to offer commercial trusts to protect asset segregation, constitute a separate fund, invest pension funds and execute fiduciary obligations owed directly to beneficiaries.

The development of an independent and respected trustee which is properly regulated will be critical to maintaining public confidence in a more universally accessible pension fund. A difficult question here is the extent and degree of control retained by the government. At one extreme the government might adopt the Singaporean model and take charge of the investment fund as a Sovereign Wealth Fund (SWF) for investment abroad. However, as noted in Chapter 4, doing this would deny the potential for developing the second and third pillars. On the other hand, an independent trustee will undoubtedly require safeguards against private conflicts of interest when the fund is invested domestically.²⁹⁹ For this reason, it will be desirable to consider the regulatory framework within which the trust will operate (see Chapter 7).

6.2 ROLE OF GOVERNMENT

6.2.1 THE GOVERNMENT AS TRUSTEE OF THE BANGLADESHI PROVIDENT FUND

The need for an independent trustee stems from a number of difficulties associated with the government acting as a trustee of the provident fund. The Bangladeshi *Trusts Act*, 1882 has not

²⁹⁷ Donald, S (2010) *What Contribution does Trust Law Make to the Regulatory Scheme Shaping Superannuation in Australia*. (Unpublished thesis, University of New South Wales).

²⁹⁸ Dyer, A and Loon, H (1984) 'Report on Trusts and Analogous Institutions', Hague Conference on Private International Law, edited by the Permanent Bureau of the Conference, The Hague, Netherlands, pp. 40-65. They also mention resulting and constructive trusts and bank account trusts.

²⁹⁹ Hoser, T, Hezell, K and Waldron, D (2002) 'Australia: Some Legal Issues Relating to Superannuation Trustees as Hedge Fund Investors', December edition, 19 *AIMA Journal*.

strictly mentioned the account and governance requirements on business and financial matters. In the Bangladeshi pension fund system, whether in the public or private sector, there is no separate trustee for handling the funds. The government believes that it is able to act satisfactorily as a ‘trustee’ for its own employees in managing pension and provident funds. On the other side, however, citizens have no clear conception of the role of the government and its powers. For example, members receive 12.5% interest on their funds but are uncertain as to whether this accumulation in their fund derives from the government’s budget. The government clearly has the capacity to act without the consent of members if it needs to meet a budgetary deficiency or the needs of an Annual Development Project (ADP). In these circumstances there is a need to distinguish between the role of the government as a form of administration and, in effect, as a ‘trustee’ and provider for employees. The fundamental problem is that the government believes its employees’ pension funds are in safe hands. It also believes that the best interest is being paid to the beneficiaries of these funds with safeguards in place.

The same considerations apply to the private sector’s provident fund system. Here employees do not know how their funds are invested or the policies regarding their administration. The employer does not have a separate trustee to look at what will benefit employees. There is no legal accountability to the funds in such a way the employees can obtain a more competitive benefit. That is why people do not have trust the government and private trustees, and the idea of a separate trustee should be seriously considered for non-government employees.

However, a trustee is considered to be a fiduciary. Generally, the trustee must act prudently, using the same care and skill that an expert would in similar circumstances.³⁰⁰ In Bangladesh, the law says that a trustee is bound to act as carefully as a man of ordinary prudence. In the absence of trust deed or contract, the trustee in Bangladesh is not responsible for loss, destruction or deterioration in dealing the trust property which is a major shortcoming of the trustee standard.³⁰¹ The principle of trustee standard indicates that the trustee is liable even though he has done his best, if his best is not good enough. He has to prove that he has done his job with honesty,

³⁰⁰ *Trustee Act 1925 (NSW) s. 85; Trustee Act 1893 (NT) s. 26; Trustee Act 1936 (SA) s. 56; Trusts Act 1973 (Qld) s. 76; Trustee Act 1898 (Tas) s. 50; Trustee Act 1958 (Vic) s. 36; Trustee Act 1962 (WA) s. 75.*

³⁰¹ Section 15 of the *Trust Act*, 1882 of Bangladesh.

reasonable care, prudence and circumspection in order to avoid being charged.³⁰² In the area of trustee investments the law considers the responsibilities of the trustee from the position of the ordinary prudent man. In *Re Whiteley* (1886) 33 Ch.D. 347 Lindley L.J. observed that a trustee must be morally bound to ensure the standard of trustee's duty by taking such an utmost care distinct from ordinary care. In diversification of trust funds for investment, it is certainly required to make a distinction between authorised and proper investments in order to minimise losses and ensure the highest rate of return.³⁰³

6.2.2 BANGLADESH GOVERNMENT'S RECORD AS A TRUSTEE

Due to the lack of clarity in the Bangladesh government's role as a government and trustee/pension fund provider, there are likely to be problems in its discharge of the role of trustee. This is in fact the case. A superannuation or pension fund is a primary investment vehicle for citizens because of its concessional tax offer.³⁰⁴ In developed countries the return of the benefit is allocated to the beneficiary because the investment has a diverse character. There are separate regulatory authorities ramping up their compliance needs to ensure the pension fund is only utilised in accordance with the government's retirement savings policy objectives, to provide benefits to the fund members or their dependants upon retirement or death.³⁰⁵ Furthermore the budgetary pressures make it difficult for the government to provide retirement benefits to its employees. The government pays money to meet the liabilities on people's retirement from its consolidated revenue rather than from a managed trust fund for which a trustee is legally responsible. There is a difference between meeting the retirement needs of government employees from consolidated revenue and from an established and supervised trust fund.

A first difficulty is that the government simply uses the fund to meet its budgetary shortfalls. As a trustee the government must adhere to essential features of trust law considered above. In particular breaches of fiduciary duty to beneficiaries do not keep the fund separate from

³⁰² *Re Chapman* (1896) 2Ch.763 at p.778 as Lopes L.J said that if the trustee exhibits the requisite higher degree of care as an ordinary prudent man , then he will not be liable for any mistakes.

³⁰³ Marks. B and Baxt. R (1981) *Law of Trusts*, CCH Australia Limited, Sydney, pp. 1015-1019.

³⁰⁴ The legal framework for the operation of Australian superannuation funds has also been codified into the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and the taxation rules laid down by the *Income Tax Assessment Act 1997* (ITAA 1997).

³⁰⁵ Jones, S (2008-09) *Australian Superannuation Handbook*, Thomson Reuters, Sydney Australia, p. iii. The *Superannuation Guarantee (Administration) Act 1992* of Australia requires all employers to make a minimum level of superannuation contributions (currently 9.5%) on behalf of their employees.

government funds. The government often has a financial and budgetary shortfall to meet due to current account deficits. To meet its budgetary shortfall the government takes a necessary portion from the contributions held in pension and provident funds.³⁰⁶ It does so under the guise of a prudent trustee of the relevant funds. This self-regulatory behaviour on the part of the government is detrimental to the ultimate and wider benefit of the contributors themselves. Again, this pretense by the government acting as a trustee and employer is another essential reason for Bangladesh to implement a universally accessible pension fund that has the confidence of the Bangladesh people. It would mean that they trust having a separate trustee system within a corporate framework. This scenario also applies to the private employer / employee provident funds level.

The second difficulty concerns the blurred lines of capital ownership when the government acts as trustee as well as in capacity of government. Currently the Bangladesh government accumulates contributions from its employees, and allocates funds according to its own priorities in national wealth creation under a pension and provident fund scheme. Likewise, a small number of private sector employers also receive and accumulate contributions from their employees into a provident fund system which is then allocated by the employer primarily for the benefit of the employer, and not the employee. At the end of each year, only a small portion of the interest earned on the fund asset allocation, is returned to the employees in both sectors. It is at a rate of fixed interest subject to the discretion of the government and private sector employer.³⁰⁷

6.2.3 LESSONS FROM THE U.S. GOVERNMENT AS TRUSTEE

There are two clear reasons for distinguishing the role of government and trustee in relation to the pension and provident fund system of Bangladesh with specific reference to government employees. Firstly, the government is not truly satisfactory as a trustee for its employees. Once funds are appropriated to meet the purposes of government, the relationship between government and those receiving the benefits of the provident fund is that of employer-employee. This

³⁰⁶ Byron, R. K and Rahman, F (2011), note 113.

³⁰⁷ TIB (2005),note 150.

relationship is distinct from that of trustee–beneficiary. For example, the government can be discharged from the trust at any time or to refuses to act as a trustee (especially during termination of its employees or in exercising its discretionary power over employees). There is an inherent conflict in self-regulation. In other words, this trustee system does not have an independent trustee entity. In *Cobell v. Salazar* in the United States this type of issue was tackled.

The *Cobell* lawsuit was about compelling the Trustee for Individual Indians (IIM Trust), administered by the United States’ Department of the Interior, to fulfill its historic trust obligations to American Indians. The IIM Trust was created in 1887 with the passage of the *Dawes Act*, 1887 by the Congress. The law involuntarily took from Native Americans legal title to millions of acres of valuable lands that were to be held in trust and managed for the benefit of thousands of individual Indians. However, the trust assets for Indian beneficiaries held by the government were badly mismanaged. The Department of Interior and the Treasury were both sued as the federal government's "trustee-delegates” for breach of their fiduciary obligations. In this case, the government managed a trust fund comprising tens of millions of acres of land and trust monies collected for Indians from third parties by leasing and selling oil, gas, minerals and timber on Indian lands. The government used this money for its own ends without any accurate accounting. The leading US District Court Judge, Mr. Royce C. Lamberth, held that the government was liable because it had failed to manage trust monies for the beneficiaries. He concluded that the IIM Trustee had a conflict of interest in attempting to regulate itself. He found that there had been an error of law and jurisdictional error and reversed the original decision of the District Court of Columbia.

The case holds significant lessons for any government acting as a trustee, and particular lessons for the government of Bangladesh in administering a pension fund scheme. In relation to the role of government, *prima facie*, the government of Bangladesh in the longer term should not act as trustee of the pension and provident funds on behalf of contributing employees. Given the situation currently existing at both the government and private sector levels, real changes are needed in the regulatory system in Bangladesh by establishing an office for a corporate regulator and prudential regulator.

Government employees or agencies who are acting as ‘delegated trustees’ for providing pension and provident fund facilities to other employees are not independent of the management and business relationship of government. This is also a breach of the public trustee system because without accountability and separate entity a trust is a legal fiction. A well-documented problem with the government-managed trust accounts emerged in the *Cobell v Norton* case.³⁰⁸ It was a class action lawsuit against the federal government of USA on 10 June, 1996. After 13 years in 2009 there were rulings made by the Federal District Court and the US Court of Appeal that the government blatantly had breached its trust obligations to Native (Indian) Americans who are the country’s poorest people. The courts found that the billions of dollars of individual Indian trust funds had been misappropriated and used by the government for its own benefit. The accounts have been misplaced and stolen from American citizens - their money earned on their lands - by the same trustee who is compelled by law to protect those citizens. In such a case an independent accounting system with complete disclosure of the conduct of the trustee must be supported by the records and other competent information reflecting the trustee's management of beneficiaries’ assets.

This is the all important consideration for how a universally accessible pension fund might be effectively managed for investment and directed to capital-raising both within Bangladesh and internationally. Rawles’ theory of social justice provides some insight regarding how Bangladesh might proceed to create social justice for its people. The contributions made by fund members or an identifiable group is aggregated into the national savings pool, which is then made available for national or international investment, thus allowing derived benefits to be redistributed back to the funds’ members, and ultimately society itself. This property redistribution system may promote social and economic justice in Bangladeshi society.³⁰⁹ It would help satisfy the constitutional commitment of the government to provide planned economic growth and prosperity for its citizens, as stated in Article 15 of the Bangladesh Constitution.³¹⁰ At the same time, it would uphold the election manifesto of the present government of Bangladesh, as stated

³⁰⁸ *Cobell v Norton* (reported, DC of USA, Lamberth CJ, Mark J, Civ/ Appeal No. 96-1285 RCL, 10 June 1996), retrieved from <<http://www.indiantrust.com/index.cfm>>.

³⁰⁹ Kelso, L and Hetter, P (1967) *Two-Factor Theory: The Economics of Reality (Kelso Random House,) and Democracy and Economic Power: Extending the ESOP Revolution*. New York: Vintage Books. The authors have also described the social adjustment process in society as economic harmony. There are three essential and interdependent principles in this system of economic justice, including the Principle of Participation, the Principle of Distribution, and the Principle of Harmony.

³¹⁰ Article 15 of the Bangladesh Constitution, Note 2.

in its Vision 2021 document and its Charter for Change (Election Manifesto, 2008).³¹¹ One result of building a social safety net for Bangladeshi citizens will be the reduction of political instability due to civil unrest. Procedurally, the process of accumulating national savings rests upon the development of suitable corporate law and trust law regimes, including the adoption of transparent corporate management practices.³¹²

6.3 TRUST LAW IN THE AUSTRALIAN MODEL

6.3.1 KEY FEATURES

In this section, the author identifies key features of trust law as that body of law has evolved. The trust is a peculiar creation of the common law which grew out the mediaeval Court of Chancery's ability to give relief to litigants who were unable to get justice from the royal courts of that time. The trustee is a natural person who is considered to be a legal person in the eye of law. The trust law is mainly case law. In other parts of the world, countries which derived their legal systems from England as the result of settlement have the trust as part of their legal machinery. The trustee has a personal obligation to deal with some specific property (the trust property) for the benefit of another person (the beneficiary), or for a specific purpose.

The person who provides property to the subject of the trust is known as the 'settlor'. The trustee is a legal owner of the trust property. The beneficiary has an equitable interest in the property. It is not necessary to consider trust as a separate legal entity. A trustee may be created by will or by deed or declaration *inter vivos*. The settlor may name him or herself as a beneficiary, but if he is the only beneficiary there can be no trust as there is no equitable obligation to another person. A trust must have beneficiaries unless it is a charitable trust. Generally beneficiaries may enforce a trust but the Attorney-General in Australia enforces charitable trusts. Trusts can be express trusts or they may arise as the law sees fit.

In the 21st century developments in the area of trust law have provided wide powers to the trustees regarding the disposition of property and exercise of discretion for the benefit of

³¹¹ Election Manifesto (2008) 'A Charter for Change', Bangladesh Awami League, Ninth Parliamentary Elections, 5 December <<http://www.albd.org>>.

³¹² Donald, S (2010), note 285.

beneficiaries. There is an important link between the administration of trusts and the development of key principles of administrative law, such as natural justice. In Bangladesh, administrative law is underdeveloped and provides little accountability for administrative officers. In contrast the trustee administrator must be responsible to the beneficiary members of the fund. These developments are evident in the context of modern administrative law and principles of natural justice. Ultimately, concepts of natural justice were absorbed into administrative law and have by-passed the law of trusts.³¹³ Trustees now handle large funds in which the notions of natural justice are involved. Therefore, trusts and powers are closely related.

Generally, a trust exists when the holder of a legal or equitable interest in certain property is bound by an equitable obligation to hold his interest in that property that is not to his own exclusive benefit, but for the benefit, as to the whole or part of such interest, of another person or persons or for some object or purpose permitted by law.³¹⁴ The trust is a fiduciary relationship between the parties in respect of the property that is the subject of the trust, and to regard the personal obligation of the trustee to the beneficiary and the interest of the beneficiary in the property. An Australian superannuation fund trustee is almost always a corporate entity that holds a legal or equitable interest in the trust money for the terms of the trust. The trustee is required to fully account for the use and investment of trust property.

In Australia, many important principles of trust law have developed from case law. Australia's modern trust law, as it has been absorbed and adopted in the *SIS Act 1993*, enables the investment of the fund largely in the trustee's discretion but provides statutory guidance in the exercise of that discretion through the requirement that the trustee decide upon an investment strategy.³¹⁵ A trustee who invests within the constraints of the investment strategy is considered to have discharged its legal duties of care, prudence and caution when selecting investments. In these ways, Australia has adopted a form of statutory guidance for the 'prudent investor' approach used in the United States.³¹⁶

The trustee is considered the legal holder of trust property. Investors' protection of superannuation funds requires a trustee. The trustee may appoint managers to undertake the

³¹³ Maclean, D.M (1989) *Trusts and Powers* the Law Book Company Limited, UK, p. 1.

³¹⁴ Meagher R.P and Gummow, W. M. C (1986) *Jacobs' Law of Trusts in Australia*, 5th edition, Butterworths, Sydney, p. 7.

³¹⁵ S. 52(2) (f) of *Superannuation Industry (Supervision) Act 1993 (SIS)* (Australia).

³¹⁶ Ford, H.A.J and Lee, W.A (1990) *Principles of the Law of Trusts*, 2nd edition, The Law Book Company Limited, Sydney.

investment of the fund. The approved trustees are, for the most part, public statutory trustee companies. It is clear that the trustee owes equitable duties to individual unit holders. The legislation may have the effect of imposing statutory duties if the trustee is obliged to perform duties in accordance with the agreement on behalf of unit holders. The trustee has the fundamental duty of holding the capital that constitutes the trust fund.³¹⁷

The trust deed gives the trustee powers to remove the manager in certain circumstances.³¹⁸ The trustee would have to act in good faith in exercising its powers in relation to the managers and any other powers given by the deed or the legislation.³¹⁹ The trustee must show the highest degree of care and diligence when executing one's duty without negligence or default. The trustee must not be exempted from liability for breach of trust.³²⁰ Where a trustee breaches his or her trust he or she will be required to pay compensation that will put the trust back in the position in which it would have been if the breach had not occurred.³²¹ However, the trustee can be relieved by the court from personal liabilities if trustee proves that he or she has acted honestly and reasonably in accordance with the legislation.³²² There are beneficiaries' rights to obtain proper benefits and information about the trust property and trust documents.

The general duty of a trustee is to act in good faith on behalf of the trust. The trustee's duties derive from the trust instrument, general law and statute. The trustee's duties include³²³ but are not limited to, ascertaining what is the subject of the trust; adhering to the terms of the trust which may only depart from the terms of the trust with the approval of the court; act in good faith, not deriving a profit from the office. Additionally, the trustee is charged with preserving trust property, including investing property, insuring it, and managing it with reasonable care. This is onerous to the trustee because the object of the investment is to protect the capital of the trust as well as to maintain a good income stream for any beneficiaries of income. Furthermore, the trustee must keep full accounts of the trust property so that proper trust accounts are produced

³¹⁷ *Bank of New South Wales v. Vale Corp. (Management) Ltd* (unreported N.S.W.C.A., 21 October 1981) referred to by Stewart, Unit Trusts – Legal Relationships of Trustee, Manager and Unit holders: (1988) 6C. & S.L.J.296.

³¹⁸ *Elders Trustee and Executor Co. Ltd v. E.G. Reeves Pty Ltd* (1987) 78 A.L.R. 193.

³¹⁹ *Parkes Management Ltd v. Perpetual Trustee Co. Ltd* (1977) 3 A.C.L.R. 303.

³²⁰ *Australia's Companies Act*, s.177; *Corporations Act*, s 1076.

³²¹ *Hagan v Waterhouse* (1992) 34 NSWLR 308.

³²² *Trustee Act*, note 276.

³²³ Vermeesch R B and Lindgren K E (1998) *Business Law of Australia*, 9th edition, Butterworths, Sydney, p. 1307.

when demanded by the beneficiaries, including providing a full response to requests for information by beneficiaries. Finally, the trustee must act impartially between beneficiaries.³²⁴

The source of power of the trustee is determined by the statute, trust instrument and court. This power can be of three types: express power, implied power and statutory power. Statutory power includes investing, applying to the court for directions, sale or power to postpone sale, mortgage trust property, insure, delegate, give receipts, and settle debts, maintenance and advancement. The trustee has a right to be reimbursed for expenses incurred in carrying out duties for the trust, and to an indemnity for the debts or other liabilities incurred in administering the trust.³²⁵

The author argues that the Australian pension model might provide two important regulatory precedents for Bangladesh: firstly, in relation to the protection of universally accessible national pension funds members; and secondly, the ability to invest the fund and redistribute wealth to ends of broader social justice and economic security for the people of Bangladesh.³²⁶

6.3.2 THE SUPERANNUATION ENTITY IN AUSTRALIA

Entity is defined as an individual, a body corporation, a partnership and a trust.³²⁷ Section 10 of the *Superannuation Industry (Supervision) (SIS) Act 1993* defines the superannuation entity as a regulated superannuation or an approved deposit fund or a pooled superannuation trust. This superannuation entity is regulated by the Australian Prudential Regulation Authority (APRA), Australian Securities and Investment Commission (ASIC) and the Insurance and Superannuation Commissioner. Superannuation trusts in Australia and the United Kingdom are considered to be institutional investors. This entity has the corporate governance and commercial authority to exercise its investment power. In Australia as of March 2007, the superannuation fund industry

³²⁴ Hayton, D (1990), 'Developing the Law of Trust for the Twenty First Century', *Law Quarterly Review*, Vol 106, at p. 87.

³²⁵ The right to indemnity arises both at general law and has been confirmed by the various Trustee Acts in each jurisdiction.

³²⁶ Bateman, H (2009), 'Retirement income provision in Australia-outstanding design issues in a mature system, *Discussion Paper*, CPS, UNSW, Sydney <<http://www.docs.fac.unsw.edu.au>>

³²⁷ S.10 of the *Superannuation Industry (Supervision) Act 1993 (SIS)* (Australia).

held approximately AUD\$425.6 billion in the Australian equity market (approximately 28 per cent of the local market).³²⁸

Australia's superannuation system forms the backbone of the nation's pension system. The pension system is supported by three pillars: a means-tested age pension; compulsory super contributions (i.e. the Superannuation Guarantee); and voluntary contribution schemes.³²⁹ It is fast becoming a primary investment vehicle for individuals attracted by its concessional tax status. Superannuation funds are established as legal trusts in order to provide benefits to fund members or their dependants upon retirement or death.³³⁰ There is a trust deed or governing rules in the superannuation fund while it is invested as a trust. This trustee owns the assets of the fund and holds them on behalf of the members, and has the primary legal responsibility for safeguarding the assets, for the financial performance of the fund, and for appointing and overseeing other persons who have duties to carry out in relation to the fund.

This type of superannuation fund developed within a legal framework formulated from principles of general trust law applicable in common law jurisdiction. Beside this, the rules of Australian taxation law apply to superannuation law. The term 'superannuation fund' is defined in s 10 of the *SIS Act* as a fund that 'is an indefinitely continuing fund' and is 'a provident, benefit, superannuation or retirement fund'.³³¹ A regulated superannuation fund is required to obtain tax concessional treatment.

6.3.3 EVOLUTION OF AUSTRALIAN SUPERANNUATION FUNDS INTO A CORPORATE STRUCTURE

In Australia superannuation funds are trust funds created by the establishment of the superannuation fund. Section 5 of the *SIS Act* states that superannuation entities must comply with superannuation funds, approved deposit funds and pooled superannuation trusts. Section 38 of this statute defines 'entity' as the fund, scheme or trust. The superannuation fund must have a trustee. The trustee must be a corporation or the fund a 'core purpose' pension fund. This trust receives a favorable tax treatment if it complies with the *SIS Act* and other relevant legislation.

³²⁸ Australian Bureau of Statistics, *Managed Funds* (Cat. No. 5655) (1st March 2007), 1.

³²⁹ Australian Industry Report (2011) Superannuation funds in Australia, *IBIS World K 7412*, 44.

³³⁰ Jones, S (2008-09) *Australian Superannuation Handbook*, Thomson Reuters, Sydney, p. 1.

³³¹ Section 10 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) (Cth).

Superannuation funds and trusts are subject to Commonwealth regulation (corporations and pensions powers).

6.3.4 ROLE OF RESPONSIBLE ENTITY AS A TRUSTEE AND INVESTMENT MANAGER

Under the *Managed Investments Act, 1998* (Cth) ('MIA' Act) a responsible entity is a peculiar legal invention in Australia to replace the manager and trustee in managed investment schemes. It is a very significant amendment to the prescribed interest provisions contained in the *Australian Corporations Act, 2001*(Cth). It is synonymous with "trust". Australia has long been familiar with the unit trust structure under which property is held by a trustee and turned to account by a management company. The beneficial interest in the trust fund is divided into units as evidenced by certificates held by investors.

There is a general trust principle underpinning this arrangement. Indeed, Chapter 5C of the *Corporations Act, 2001* ('Managed Investment Schemes') notes that the corporate responsible entity holds scheme property on trust for scheme members.³³² It was held in *Investa Properties Ltd v Westpac Property Funds Management Ltd (2001) 187 ALR 462* that the managed investment scheme structure brings with it an unavoidable duty of trust law. The trust concept imposes requirements fiduciary attention to beneficiaries' interests. It was also maintained in *Re Mirvac Ltd (1999) 32 ACSR 107* that the responsible entity under a registered managed investment scheme is a 'trustee' for the purposes of that legislation.

The responsible entity must be a company of a particular kind and the scheme property is held by the responsible entity as a trustee. Therefore, a two-tiered trustee and management company regime with a single corporate responsible entity generally used in common law jurisdiction has been established by this new arrangement. The corporate responsible entity holds scheme property on trust for scheme members. A corporate responsible entity has the power to appoint an agent to do anything that it is authorised to do in connection with a scheme. This may include the appointment of a custodian to hold scheme property on behalf of the responsible entity. A

³³² The *Corporations Act, 2001* (Cth) s. 601FC(2).

corporate responsible entity has the dual role of trustee and manager of an investment scheme, and must be appointed if an investment scheme has to be registered.³³³ This entity is itself a legal corporation in which the functions of trusteeship and investment management have been merged. The duty of the corporate responsible entity is to act in the interest of members, treat members of each class equally (different classes fairly) and report breaches of the *Corporations Act* to ASIC.³³⁴

6.3.5 DUTIES OF THE TRUSTEES UNDER THE SIS ACT 1993

The trustee is responsible for all aspects of the management and operation of the scheme including governance, investment management, compliance with superannuation and other relevant laws, financial management, member records, administration and member and employer services.

In Australia the superannuation trustee has a duty to establish arrangements for inquiries and complaints [s10], seek information from the investment manager [s102], establish procedures for appointing member representatives in relation to an employer sponsored fund [s107], independent trustee or independent board members of corporate trustee [s 108]. Such a trustee must also invest a superannuation entity on an arm's length basis [s109], notify the APRA of significant adverse events [s116], appoint investment managers in writing [s124], maintain standards for trustees, investment manager and custodians [Part 15], handle suspension/removal of the trustee if required [Part 15], and abstain from any prohibited conduct [Part 18].

In the next two sections the way in which trust law has been readily used in Australia is outlined. Firstly, the foundation for the duties of the independent superannuation fund trustee is described. Secondly, the starting point for extending trustee powers to include wider investment powers is considered.

6.3.6 GOVERNING RULES AND COVENANTS UNDER THE SIS ACT 1993

³³³ Ford, HAJ, Austin, RP and Ramsay, IM, Ford's (2007), *Principles of Corporation Law*, Chatswood, N.S.W. LexisNexis Butterworths.

³³⁴ The *Corporations Act*, 2001 (Cth) s. 601FC.

Section 52 of the *Superannuation Industry (Supervision) Act, 1993* provides that where a trustee of a superannuation entity is a company, the covenants specified in section 52(2) bind each of the Directors of the Board as if they were parties to the governing rules. The Directors are bound to exercise a reasonable degree of care and diligence for the purposes of ensuring that the Board of Directors carries out the covenant (section 52(8)). With respect to general law, the Directors of a Trustee Company do not directly owe duties to beneficiaries; they merely owe duties to the company to act in its best interests. The practical effect of the duty imposed on the Directors by the covenants is that each Director now owes a direct duty under the governing rules to members or beneficiaries to ensure that the superannuation scheme complies with all statutory covenants, including the requirement of the *SIS Act, 1993* in general. It is therefore possible that members or beneficiaries may bring an action against the Directors directly if the Board of Directors contravenes the covenants or the requirements of the *SIS Act, 1993* which results in loss or damage to the members or beneficiaries.

The standard of care for the purposes of section 52(8) is the degree of care and diligence that a reasonable person in the position of Director of the Trustee would exercise in the trustee's circumstances (section 52(9)). The section 52 (2) of *SIS Act* has clearly prescribed powers and obligations to the trustee. Essentially, the required conduct of the trustee is one of integrity, whereby the trustee must behave honestly in all matters concerning the corporate responsible entity in relation to the trust, and as between all beneficiaries in carrying out their fiduciary relationship. Honest conduct means the trustee must only use his or her powers for the purpose they were conferred, and not compromise their position. The standard to be applied to the trustee in fulfilling their duties and meeting their obligations is an objective standard of the ordinary prudent person, rather than skills or experience. That objective standard means the trustee is required to carry out their duties and obligations prudently and must be highly ethical in their financial management on behalf of the beneficiaries, so as to not subject the trust to engaging in illegal or unauthorised transactions. Finally, to ensure the trustee's integrity is maintained, the trustee is required to be transparent in their functions and provide full disclosure in their communications with all parties.

The statutory covenant in s 52(2) (b) and (f) focus on the influence of trust law, and the particular distinctive obligations and duties of the trustee have been described in this section. It might be

from this consideration of trust law that investment powers of the trustee have been generally very restrictive (prudential standard). However, s 52 (2) (f) demonstrates how Australia has chosen to add to trust law a new dimension regarding how superannuation funds are to be invested.

In the next section, the author shows how this has been done according to Chapter 5C of the *MIA Act*, 1998. Regulation here is more about superior levels of corporate governance. Given all that has been said in the preceding paragraphs, the author's views are substantiated to the extent that if a trustee framework is adopted in Bangladesh, and regulated accordingly, then the appointed trustee must carry out their duties and obligations with the highest levels of prudential integrity and transparent conduct in both pension and mutual funds.³³⁵

6.3.7 A NEW TYPE OF CORPORATE ENTITY (CORPORATIONS ACT CHAPTER 5C)

The provision of the corporate entity under Chapter 5C of the *MIA Act*, 1998 extends the trustee's investment powers in Australia. It provides a wide range of opportunity to the trustee in managing the various investment schemes, such as 'managed funds', 'pooled investments' or 'collective investments'. Generally, these are called managed investment schemes under Chapter 5C of the *MIA Act*. It includes the people who are brought together to contribute money to obtain an interest in the scheme ('interests' in a scheme are a type of 'financial product' and are regulated by the *Corporations Act*, 2001). It also includes the money which is pooled together with other investors (often many hundreds or thousands of investors) or used in a common enterprise and a 'responsible entity' which operates the scheme. Investors do not have day to day control over the operation of the scheme. Only investments that are 'collective' are managed investment schemes. Managed investment schemes cover a wide variety of investments.³³⁶

Popular managed investment schemes include cash management trusts, property trusts, Australian equity (share) trusts, many agricultural schemes (e.g. horticulture, aquaculture, commercial horse breeding), international equity trusts, some film schemes, timeshare schemes,

³³⁵ Koh, S, Mitchell, S and Fong, HY (2010), note 50.

³³⁶ Australian Bureau of Statistics (2007), note 329.

some mortgage schemes and actively managed strata title schemes. There are other investments in Australia that do not cover the criteria of managed investments schemes, such as regulated superannuation funds, approved deposit funds, debentures issued by a body corporate, barter schemes, franchises, direct purchases of shares or other equities and the schemes operated by an Australian bank in the ordinary course of banking business (such as term deposit).

Generally, the investment manager plays a central role in a managed investment scheme by meeting the target returns for each class of investment or exceeding these returns whilst working within the risk guidelines. The investment manager manages clients' investment portfolio. In Australia the managed investments industry is regulated primarily by Chapter 5C of the *Corporations Act, 2001* (Cth). The *MIA Act* introduced the concept of the managed investment scheme. A managed investment scheme is a scheme (often in the form of a unit trust) in which people contribute money to acquire benefits produced by the scheme. These contributions are pooled or used in a common enterprise and members of the scheme do not have day-to-day control over the operation of the scheme.

The most significant feature of Chapter 5C is to consolidate the separate roles of the trustee and manager in former trusts within the single role of a corporate responsible entity. The *Corporations Act* heralded new measures (such as a Compliance Plan and Compliance Committee) to ensure adequate investor protection. Under the pre-*MIA* approach, schemes were operated by a management company and monitored by an external independent trustee. The trustee was under a statutory covenant to protect investors' interests. The *MIA Act* abandoned this two-party system, principally on the basis that it created uncertainty as to which party was ultimately accountable to scheme investors. The *MIA Act* installed a regime under which there is a single responsible entity. The legislative intention behind the 'single responsible entity' was to have one entity accountable to scheme investors.

The managed investment schemes offering interests in themselves must be registered with the ASIC where the scheme has 20 or more members or the scheme is promoted by a person who was in the business of promoting managed investment schemes. In Australia, funds management

is a big business and its people have the highest average per capita investment in managed funds in the world. The Australian funds management industry is the world's fourth largest and the largest in Asia. Most of the funds are amassed from superannuation accounts. The regulations and policies developed by the federal government have allowed this industry to grow strongly.

The funds under management (FUM) in this industry (excluding assets held by superannuation funds), were expected to reach approximately \$672.5 billion in June 2011.³³⁷ All registered schemes must be operated by a licensed public company (the 'single responsible entity'), which is subject to statutory duties of care and diligence and to act in the best interest of investors. Each scheme must have a constitution and a compliance plan managed by internal and external committee. This funds management industry comprises a number of segments,³³⁸ including superannuation, life insurance, public unit trusts, friendly societies and common funds.

Table 1: September to December 2010 key investment figures

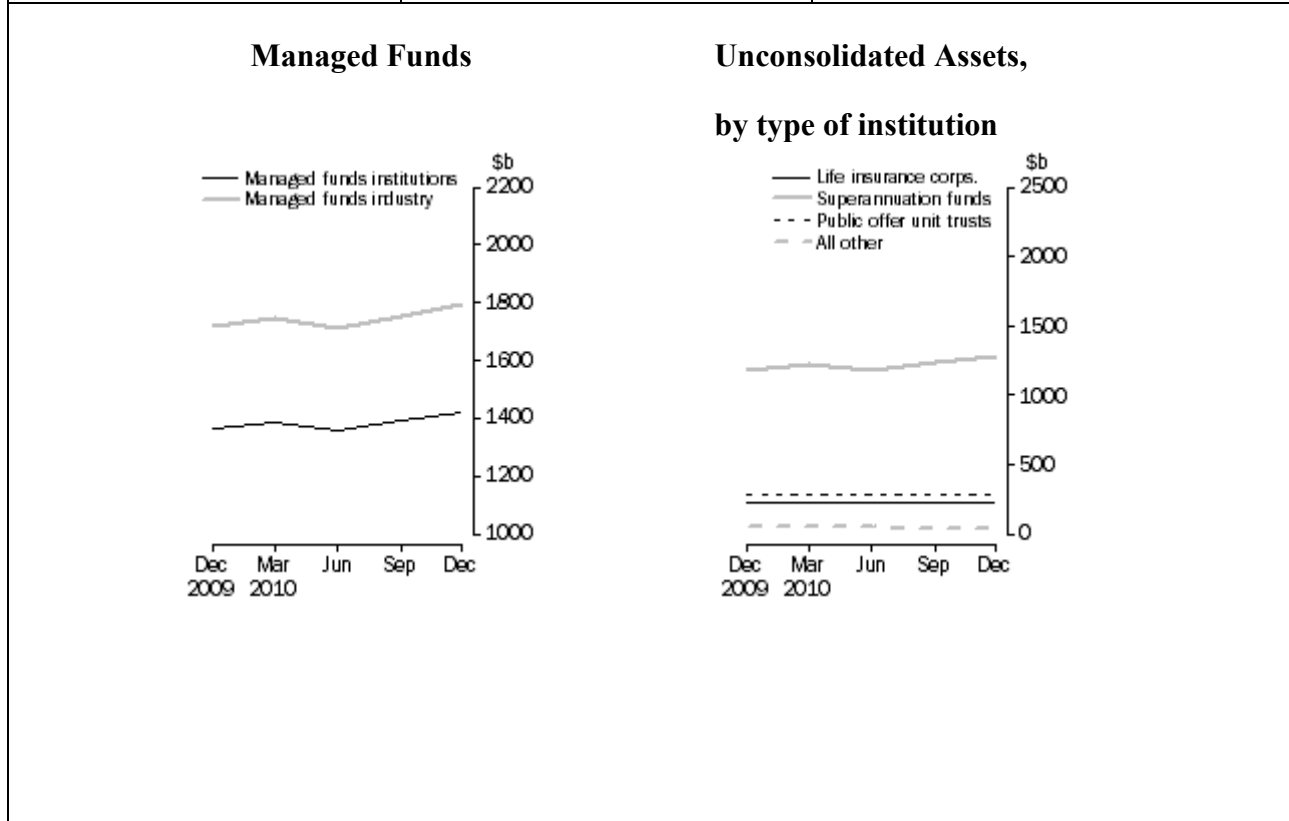
Source: Canberra Times, citing ABS figures

	Sep Qtr 2010	\$m	Dec Qtr 2010	\$m
Total managed funds industry		1 750 918		1 793 020
Consolidated assets total managed funds institutions		1 393 085		1 422 657
Cross-invested assets between managed funds institutions		402 001		415 551
Unconsolidated assets total managed funds institutions		1 795 086		1 838 208
Life insurance corporations		230 577		232 710

³³⁷ Australian Industry Report (2010) Funds Management (except Superannuation Funds) in Australia, *IBIS World* K 7514.

³³⁸ The Canberra Times, *Managed Funds, Australia*, Dec 2010 released on 25 February, 2011, citing Australian Bureau of Statistics <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/5206.0>>.

Superannuation (pension) funds	1 238 616	1 278 393
Public offer (retail) unit trusts	282 946	286 356
All other managed funds	42 947	40 749



6.4 RECENT LESSONS IN TRUST LAW IN INDIA

6.4.1 SEPARATION OF THE TRUST FROM GOVERNMENT

India has separated trust from government but the trustee is still not independent. The Indian approach is more cautious and more specifically targeting the regulation of pension funds. There are lessons for Bangladesh in the Indian experience and the Indian approach is a valuable template for Bangladesh. A trust generally serves a lawful purpose in every society. It can be created by deed, will or even word of mouth. During the British colonial regime the Indian *Trust*

Act was passed in 1882, the same year as Bangladesh adopted the same trust law. It defines the law relating to private, public trusts and trustees. In India the public trusts are classified as charitable and religious trusts which are governed by the *Charitable and Religious Trusts Act*, 1920, the *Religious Endowments Act*, 1863, the *Charitable Endowments Act*, 1890, the *Societies Registration Act*, 1860, and the *Bombay Public Trust Act*, 1950. It is not necessary for trust to become a legal person. Basically the *Indian Trusts Act*, 1882 governs the private trusts.

Trusts in India are currently being used as pooling vehicles for investments, such as mutual funds and venture capital funds. The SEBI (Mutual Funds) Regulations and the SEBI (Venture Capital Funds) Regulations govern these types of trusts under the separate set of regulations.³³⁹ The existing mutual funds regulations such as the *SEBI (Mutual Funds) Regulations*, 1996, were amended and these regulations are now known as the *SEBI (Mutual Funds) Amendment Regulations*, 2009 which provide a separate legal framework for mutual funds.³⁴⁰

6.4.2 TRUSTEE'S PERFORMANCE AND STANDARD OF CARE

The trustees under the *Indian Trusts Act*, 1882 are required to act in accordance with the directions provided in the trust document. The purpose of the trust must be lawful. Section 15 of the *Indian Trusts Act*, 1882 provides that unless it has been specifically provided for in the trust document either universally for the entire trust corpus or with respect to certain specific properties, the trustee cannot be held liable for any loss, destruction, or deterioration caused to the trust property unless the act through which the loss is caused is not bona fide. The trustee is assumed to be a reasonable person and is expected to exercise reasonable care.

The different standards raised for trustees under the Indian Trust Act reflect much the same standards required of directors acting 'in good faith' and with 'reasonable care' under the Corporations Act in Australia, and in earlier case law. Under Section 180 of the Australian

³³⁹ Hanisha, A and Bijal, A (2009) *Trust Law*, Nishith Desai Associates, New Delhi, India, p. 275.

³⁴⁰ KPMG (2009), 'The Indian Mutual Fund Industry- The future in a Dynamic Environment: Outlook for 2015', KPMG International, Swiss Cooperative <<http://www.in.kpmg.com>>.

Corporations Act 2001 the requirement that directors and officers act with 'reasonable care' is a civil obligation only. By contrast, a breach of the requirement that directors and officers exercise their powers and discharge duties in good faith and for proper purposes (Section 181) has both civil and criminal consequences.

The trustee is not liable for such a loss unless the loss has been caused by behaviour which is not bona fide. The following standards of care with respect to the trust property have been laid down under the Indian *Trusts Act*. It includes the basic principles of informing the trustee itself about the state of the trust property, ensuring title, caring reasonably, and exercising impartial discretions and powers. It also includes the standard of care of a trustee in preventing trust property from threats and destruction. The burden of responsibility is on the trustee in investing trust money and managing funds prudently.

6.4.3 BENEFICIARY'S RIGHTS IN INDIAN TRUST LAW

The beneficiary has the legal right to undertake court action if the trustee fails to take reasonable care in administering the trust in a proper manner. A civil suit for enforcing the beneficiary's rights against the trustees or their legal representatives or for enforcement of trustees' duties can be instituted in the event that the trustee fails to take a relevant matter into account in administering the trust. The beneficiary has a right to demand a copy of the trust document as well as the accounts of the trust from the trustees. In the event of non-compliance with any of the provisions of the trust document or discrepancy in accounts or fraud, etc., the beneficiaries can appeal to the court for the trustees to correct the matter.

6.4.4 TRUSTEE'S INVESTMENT POWER UNDER THE INDIAN TRUSTS ACT 1882

The *Trusts Act*, 1882 of India gives trustees complete freedom to invest the trust fund in the absence of specific instructions in the trust deed. Section 20 of the 1882 statute describes the guidelines in which the trust money is to be invested. It states that where the trust property consists of money and cannot be applied immediately or at an early date for the purposes of the

trust (if provided), the trustee is bound (subject to any direction contained in the trust document) to invest the money in the following securities, and in no others:

- a) securities such as promissory notes, debentures, stock, or other securities of the central government by notification in the Official Gazette;
- b) units issued by the Unit Trust of India under any unit scheme made under section 21 of the Unit Trust of India Act, 1963;
- c) immovable property situated in India provided that the property is not a leasehold and that the value of the property exceeds by one-third, or, if consisting of buildings, exceeds;
- d) by one-half any of the mortgage secured over the property.

Section 20(ee) of the *Trusts Act*, 1882 comments on the units issued by the Unit Trust of India under any unit scheme which has expanded the opportunities for the capital investment under the mutual funds mechanism.³⁴¹ The trustee holding the entities is responsible for segregating the trust assets and liabilities at the time of trading to prevent them from incurring personal liabilities and to secure transparency. The 1882 statute states that if the trustees hold entities that trade directly, any action taken in respect of these assets which causes loss to the trust fund will not be held against the trustee unless the actions are not bona fide.³⁴² On the other hand, this Act gives the legal right to the beneficiary to take action against the trustee for breach of trust in making imprudent investments and seek reconstitution of the trust fund.³⁴³

6.4.5 TRUSTEE'S OBLIGATIONS TO DISCLOSE TRUST INFORMATION

A trustee is legally bound to keep clear and accurate accounts and supply information to the beneficiary on his or her request or voluntarily about the fund, investment and income of the trust property.³⁴⁴ Section 57 of the *Indian Trust Act*, 1882 gives a beneficiary who has knowledge of the trust the right to inspect and take copies of the trust document, the title documents relating to the trust property, the accounts and the respective supporting vouchers, and the cases submitted

³⁴¹ Section 21 of the *Unit Trust of India Act* 1963.

³⁴² Prudential Principle - where the investments have been made through a wholly owned company and the prudential principle applies, such that an action cannot be brought.

³⁴³ *Bartlett v Barclays Bank Trust Co Ltd* [1980]Ch 515 in English trusts case.

³⁴⁴ Section 19 of the *Indian Trusts Act*, 1882.

and opinions taken by the trustee for his guidance in the discharge of his duty. It should be noted that in the case of a discretionary trust, the trustees are under no obligation to disclose their reasons for making decisions to the beneficiaries.³⁴⁵ This section of the Indian statute demands a separation of the trust fund and its operations from other funds so that the trustee's legal obligations are satisfied.

6.4.6 LEGAL IMPACT OF MIXING TRUST ASSETS WITH OTHER ASSETS HELD BY TRUSTEE

Section 66 of the Indian *Trusts Act*, 1882 states that the mixing of trust property with other assets held by the trustee is *per se* a breach of duty. The beneficiary has the legal right to claim benefits on the whole fund due to the beneficiary because the fund has been mixed with other funds. Therefore the trustee is not allowed to mingle the trust fund or property with other assets held by him. According to provident fund law, the Bangladeshi Provident Fund is a trust fund which is commonly mingled with other assets held by the government of Bangladesh. To date this fund is not separate from other government funds.³⁴⁶ Striking evidence of this fact was found in the author's own research when senior government officials were unable to say precisely how much has been contributed to the fund to date by government employees. It appears that the Indian government, by contrast, is addressing this flaw through the separation of the fund from other government funds.

6.4.7 TAX CONCESSIONS IN TRUSTS INVESTMENT IN INDIA

In India private sector trusts are not subject to tax concessions. Private trusts are concerned with small or closed groups. In contrast public trusts concern a large group of beneficiaries and contributories. The trustee is under an obligation in accordance with the provision of Chapter XV of the *Income Tax Act*, 1961 to pay tax if he makes an income from the trust for the beneficiaries. The scope of this obligation extends to all income received by the trustee for the benefit of or on behalf of trust beneficiaries. The income received by the trustee is taxed as if such income was directly received by the beneficiary. At the same time the Act permits the trustee to recover the

³⁴⁵ Hanisha, A and Bijal, A (2009) *Trust Law*, Nishith Desai Associates, New Delhi, India, p. 288.

³⁴⁶ OECD (Organisation for Economic Cooperation and Development) (1994), note 291.

tax amount from the beneficiary. Only the income of charitable trusts receives a tax concession, subject to satisfaction of the requirements prescribed by the above-mentioned statute.

6.4.8 SUPPORTING MEASURES FOR THE PROTECTION OF TRUSTS IN INDIA

The trust in India is supported by the criminal and customs legislation. Evidence Act and the Insolvency Act in protecting trust assets. There is no specific asset protection legislation in India. The Indian *Trusts Act*, 1882 does not cover the concept of protectors for trust assets. It is notable that the *Trusts Act* has sufficient flexibility to allow a protector to be appointed in the trust deed who would be liable to the beneficiaries if dishonest, fraudulent or negligent activities emerged.

6.4.9 USE OF THE TRUST ACT 1882 IN INDIAN PENSION AND PROVIDENT FUNDS INVESTMENT

Regarding pension fund investment, the Indian *Trusts Act*, 1882 is being used to establish a trustee framework operated by the PFRDA, which as stated previously in this thesis is the prudential regulator for the NPS of India.³⁴⁷ In 2009 the Indian government initiated co-contributory pension and insurance schemes within a regulatory framework for people working in the unregistered sector to save for their retirement and to reduce the operating costs of the NPS. On behalf of the poor people the Indian government will contribute Rs. 1000 per year to each NPS account opened in 2010-11 for the next three years subject to the condition that the individual subscriber will contribute of Rs. 1,000-12,000 per annum during the financial year 2010-11. The PFRDA is managing this scheme within a corporate framework.³⁴⁸

6.5 GOVERNMENT CONTROLLED TRUSTS

³⁴⁷ Since 2004 the NPS has been available to Indian citizens between the ages of 18-55 years. There is a tier-1 system mandatory for all government employees. It is a non-withdrawable pension account. The government can make an equal matching contribution. Since 1 April, 2008 the pension contributions of central government employees were covered by the NPS. This fund is being invested by the professional pension fund managers according to government investment guidelines. The government does not contribute to non-government employees' pension schemes. Individuals can operate a voluntary tier-II scheme which is a withdrawable account. The NPS does not specify in detail the tax implications for savers. <<http://www.en.wikipedia.org>>.

³⁴⁸ Bhardwaj, G (2009) Co-contributory Pension and Insurance Scheme for the Working Poor: Lessons from the Rajasthan Government Vishwakarma Yojana, Report and Recommendations, The UNDP-IIMPS national policy workshop for State Government, the Imperial, New Delhi.

6.5.1 INVESTMENT AS A SOVEREIGN WEALTH FUND IN SINGAPORE

Singapore is unique in relying heavily on a single mandatory savings regime for its citizens, known as the Central Provident Fund (CPF). The CPF is managed by the state to finance the retirement needs of Singaporeans. Additionally, there is a voluntary tax advantage retirement scheme, called the Supplementary Retirement Scheme (SRS), although the impact of this fund has to date been very limited.³⁴⁹ Singapore's retirement system consists of state-mandated and state-managed individual retirement accounts. While the CPF is administered well, there is little transparency in its investment function and the return on investment has been poor. Wages are unequal and there is a high rate of pre-retirement withdrawals.³⁵⁰

Singapore does not follow the WB's multi-pillar system. In reality, the CPF money is transferred to government investment holding companies for foreign investment and the rates of return are relatively low.³⁵¹ At the end of 1996, the majority of its assets were invested in non-marketable government bonds, issued specifically to the CPF Board of Management to meet its interest obligations. The interest on these bonds is identical with the average of short-term deposit rates of four local banks. For the last decade the effective real rate of return on the bonds has been close to zero. The money raised from issuing bonds to the CPF Board of Management is invested by the Singapore Government Investment Corporation. Its portfolio and investment performance are not made publicly available and consequently CPF members do not know how their funds are ultimately deployed.³⁵²

The Singaporean system mandates contributions which are then managed by the government without reference to individual contributors. The government effectively stands in the place of an independent trustee as occurs in the Australian system. This suggests that government agents will enjoy great autonomy when the Singaporean fund is being invested internationally. Investment choices for individual contributors are lacking, and a lack of clarity in distinguishing the contributions of members and the fund earnings makes it difficult to account satisfactorily to individual contributors what the fund earns. There remain many risk factors including

³⁴⁹ Koh, S., Mitchell, S. and Fong, HY (2010), note 50.

³⁵⁰ Koh, S., Mitchell, S. and Fong, HY (2010), note 50.

³⁵¹ Asher, Mukul G (2002) 'Provident and Pension Funds Governance and Financial Sector Development in India and Singapore', Thailand: World Bank, 10 January <<http://www.info.worldbank.org>>.

³⁵² Asher, Mukul G (1999) 'The Pension System in Singapore-Social Protection', Discussion Paper No. 9919. Washington, D.C.: World Bank, 9 February <<http://www.worldbank.org>>.

transparency, issues of adequacy and fiduciary responsibility involved in mandatory CPF savings and investment because statutory requirements are sorely lacking.³⁵³

The Provident Fund in Singapore has been a central and mandatory savings program since 1955.³⁵⁴ It is one of the world's largest and arguably most successful defined contribution schemes. However, in Singapore as well, the national mandatory CPF scheme has begun to consider its participants' investment choices in an effort to increase wealth for retirement. Since 1986 the diversification in individual investments has been allowed for CPF participants concerning a portion of assets from their CPF accounts.³⁵⁵ One possible option for Bangladesh may be to legislate for a mandatory pension system similar to that of Singapore, because this option has the potential to provide Bangladesh an effective utilisation of savings for international investment in the shorter term at least where government can uphold their supervision and control over the fund management.

6.5.2 DIRECTIONS FROM THREE SEPARATE FUND SYSTEMS

Singapore is different from India and Australia in the structure and regulation of its pension funds and is worth noting that its system is highly effective. The fund is tightly regulated by the government so that it can organise capital for strategic investment internationally. Singapore's sovereign wealth fund operates by deriving compulsory contributions in the form of a CPF from its citizens, within a trust framework. All contributions to this fund are then invested in international markets to earn the highest rate of returns for contributors. Although Singapore does not follow the WB's 'Three Pillar' system, the collected contributions from the fund are transferred to corporate entities owned by the government, which then use Singapore's sovereign wealth to facilitate offshore investments into other nations' capital resources and infrastructure. This emphasises the point that the provident fund must be invested actively and internationally for improved returns. The Singaporean government has understood the value of portfolio investment and is smart enough to do it. Bangladesh does not do so because it lacks the expertise. An independent trustee could do it but this will have to be validated in the country's constitution.

³⁵³ Asher, Mukul G (1999), note 336.

³⁵⁴ Low, Linda and Aw T.C. (1997), *'Housing a Healthy, Educated, and Wealthy Nation through the CPF'*, the Institute of Policy Studies. Singapore: Times Academic Press. Low, Linda and T.C. Aw (2004). *Social Insecurity in the New Millennium: The Central Provident Fund*. Singapore: Times Academic Press.

³⁵⁵ Koh, S., Olivia, Mitchell, S. and Fong, HY (2010), note 50.

The concept of sophisticated trust is not well understood in India. In Australia, general trust law has been codified and redrafted for the commercial purposes of both the *SIS Act* and Chapter 5C of the *Corporations Act*. As a commercial vehicle, the Indian trust does not satisfy the requirements of corporate transactions such as those in Australia. Although the *Indian Trusts Act*, 1882 provides an insight into the setting up of a trust, parties to a trust, their rights, duties and obligations, it does not guide the commercial proceedings for investment within a corporate framework. The governing statute for trusts in India is not a purely commercial one because it speaks about the personal and religious trusts.³⁵⁶ It is acknowledged that there are many mutual funds currently operating in India on a commercial basis, which are subject to the guidelines and regulations of the SEBI. The *Trusts Act*, 1882 does not provide an operational framework for the trust funds due to an absence of specific provisions such as the amount of corpus, tax treatment, uncertain subject matter, management aims, limitations, separation and liberty of investment of the said trust fund.

Bangladesh can establish a universally accessible pension fund in the light of India's co-contributory pension scheme. This type of pension fund might be effectively marshaled for investment and directed to capital-rising both within and outside Bangladesh. It might reduce potential future budgetary pressures on tax-financed old age pensions by increasing self-provision, contribute to economic growth by increasing aggregate long-term household savings, and facilitate labor mobility through fully funded portable pension accounts. As a result Bangladesh may in the future be able to meet the retirement needs of its people from an established and supervised trust fund rather than consolidated revenue.

6.6 APPLICATION TO BANGLADESH

6.6.1 GENERAL PRINCIPLES OF TRUST LAW – APPLICABILITY TO BANGLADESH

Generally the trustee is the legal owner of the trust property and its beneficiaries are the equitable owners. This legal concept establishes the basis of a fiduciary relationship between trustee and beneficiaries. The trustee is not allowed to take a personal interest or enter a conflict of

³⁵⁶ Swaroop M (2007) *Indian Trust Act - A Corporate Perspective*, *Symbiosis Society's Law College*, Pune. <<http://www.goforthelaw.com>>.

interest.³⁵⁷ The trustee may think fit to invest or manage the property in a manner which advances the interests of or benefits the beneficiaries. The trust law or law of equity requires that trustees are obliged to act in such a manner that protects the interest of beneficiaries.³⁵⁸

Under the trust law the beneficiary is a volunteer to a trust.³⁵⁹ There is a difference between a contractual relationship and a trust relationship. Under the law of general trusts we can say that the beneficiary has provided no consideration to the trust, but this technical view is not appropriate for the beneficiaries of a contributory superannuation scheme or contributory provident funds scheme. Contributions made to this scheme derive completely from employees' salaries.³⁶⁰ Here, the beneficiary's rights are contractual and have the same standing as commercial rights.

However, the principles of trust law generate the trustee's obligation to adopt an investment strategy that is in the best interests of the beneficiaries. The trustee's position would be that of an ordinary prudent person to manage the risk. The different obligations of the trustee might be considered as satisfying significant legal expectations and in particular an appropriate and effective investment strategy; what is known as modern portfolio theory.³⁶¹ This theory contends that trustees should diversify investments to determine expected returns and to manage risks in particular assets.³⁶² It is obviously the paramount duty of the trustees under the basic principles of trust law to represent and promote the best interests of beneficiaries.³⁶³ Trustees are legally liable for breaches of their obligations. While the trust has had important uses in commerce and trade in developed countries,³⁶⁴ unfortunately the principles of a sophisticated trust regime have not yet been introduced to Bangladesh. This is due to the history of non-compliance with trust administration and practices and rules regarding investment.³⁶⁵

³⁵⁷ Rt Hon Justice E Thomas, (2000) *The Conscience of the Law*, 8 Waikato Law Review, 9.

³⁵⁸ *Mabo v Queensland (No. 2)* (1992) 175 CLR 1 (HCA) 203.

³⁵⁹ Tennent, D (2009) Ethical investment in superannuation funds can occur without breaching traditional trust principles, *Waikato Law Review*, v.17, p.99.

³⁶⁰ *Mettroy Pension Trustee v Evans* [1990] 1 WLR 1587, p.1610.

³⁶¹ Ali PAU and Gold M (2002), 'An Appraisal of Socially Responsible Investment for Trustees and Other Investment Fiduciaries', (Research Paper, Centre for Corporate Law and Securities Regulation), Sydney.

³⁶² Thornton, R, (2008) Ethical Investments: A case of Disjointed Thinking, *Cambridge Law Journal* 67 (2) 396, 399.

³⁶³ *Cowan and Others v Scargill and Others* [1985] 1 Ch 270.

³⁶⁴ John H. Langbein, *The Secret life of the Trust: The Trust as an Investment of Commerce*, 107 YALE L.J.165 (1997).

³⁶⁵ Staff Correspondent (2011) 'Probe report to be published; *The Financial Express*, 19 April, 1.

The report says that many small investors in Bangladesh have suffered financial losses due to malpractice in the share market.

6.6.2 REVIEWING THE CONCEPT OF TRUST LAW IN BANGLADESH

In Bangladesh the *Trusts Act*, 1882 represents a colonial era statute that covered Indian, Bangladeshi and Pakistani trust practices. In 1999 India took the initiative to amend Section 20 of the Indian *Trusts Act*, 1882 to permit all trusts to invest in share and bonds of listed companies (from 85% to 100%).³⁶⁶ The basic constituents of a trust are translation of trust property, declaration of the purpose and beneficiary.

There is no provision in the Act concerning the use of a public sector trust for commercial purposes. In 2009 the Indian courts held that public trusts could be applied for commercial purposes in some circumstances.³⁶⁷ Section 25 of the Indian *Companies Act*, 1956 permits the government to establish non-profit companies which will promote religious and scientific objectives. The non-profit companies in India and Bangladesh can only operate private and religious charitable trusts as a matter of law. The author proposes that the non-profit companies in Bangladesh might provide the starting point for considering a new form of corporation to manage commercial trusts such as pension funds, provident funds and mutual funds. The non-profit companies might introduce the concept of the commercial trust though the adoptions of more sophisticated trust concepts (such as the Chapter 5C corporate responsible entity) available in Australia. These types of companies might differentiate the concept of commercial trust from private trust by experimenting with more sophisticated trust concepts. The Tax Act of India generally provides tax exemption facilities for charitable and religious trusts what might be applied for commercial trusts as well.

Indian companies are currently allowed to invest 85% of their accumulated trust funds and may invest 100% of their funds in the capital market. The *Indian Trust Act*, 1882 does mention unit trusts and their investment.³⁶⁸ By contrast, the Bangladeshi *Trusts Act*, 1882 permits only 25% of trust money to be invested in the Capital market.³⁶⁹ In the light of s. 20 of the country's 1882 *Trust Act*, the Provident Fund is a trust property consisting of money which should be invested

³⁶⁶ Sec 20 of the *Indian Trusts Act*, 1882

³⁶⁷ Business Standard, Wednesday, Sep 23, 2009. <www.business-standard.com/india/news>.

³⁶⁸ S.20 (ee) of the *Indian Trust Act* 1882.

³⁶⁹ S.20B of the *Bangladeshi Trust Act* 1882.

immediately as a security of the government.³⁷⁰ If so, the question raised concerning the fixed return payable to its employees by the government or by employers in the private sector at the end of the financial year is whether it is appropriate, justifiable and market competitive.

In 2000 the Bangladeshi government amended the country's trust law and added s. 20B, a statement that the maximum limit of investment of trust money would be 25% of the total fund, which could be invested in any security listed on the Bangladesh Stock Exchange.³⁷¹ This restriction on the investment of the fund is to maintain the internal security of the trust fund but it is arguably out of step with international trends. It denies full investment opportunities to contributories, hinders wealth creation, development of capital markets and may give rise to a competitive disadvantage internationally.³⁷² Related to this, the government trustee could be tempted to use the fund money for its own purposes. The government's self-dealing in the property of the trust fund is permitted, raising potential conflicts of interest and questions as to the trustee's proper discharge of fiduciary duties. The Bangladeshi government acknowledges that its employees' fund is a trust fund, but uses it for its own interests without the consent of employees.³⁷³ Such dealing for the government's own ends ignores the trustee's obligations in the absence of an express authorisation to use the trust instrument in such a way.³⁷⁴

6.7 CONCLUSION

Bangladesh must modernise its trust law and this will entail building the foundations for a universally accessible pension fund that is independent of government control. In order to pave the way for the more profitable investment of the fund domestically and internationally in the longer term, Bangladesh might also need to consider a more broadly based regulatory framework

³⁷⁰ S.20 of the *Bangladeshi Trust Act* 1882 states that where the trust property consists of money and cannot not be applied immediately or at an early date to the purposes of the trust, the trustee is bound (subject to any direction contained in the instrument of trust) to invest the money on the following securities, and no others.

³⁷¹ S.20B of the *Bangladeshi Trust Act* 1882 states that where the trust property comprises money and it cannot be applied immediately to the purpose of the trust, the trustee may, subject to any prohibition or restriction imposed in the instrument of trust, money, hereinafter referred to in this section as the maximum limit of investment, in any security listed with a stock exchange of Bangladesh.

³⁷² Ali, A. U. Paul (1999) *Marshalling of Securities*, Clarendon Press, Oxford, p. 39.

³⁷³ Senior officials in the Bangladeshi public sector were interviewed on this issue. They acknowledged that the provident fund is a trust fund. The Bangladesh government uses this fund to meet its budget shortfalls. This fund is still unfunded and uninvested.

³⁷⁴ Marks, B and Baxt, R (1981) *Law of Trusts*, CCH Australia Limited, p. 1014. In *Holder v Holder* (1968) Ch.353, it was established that self-dealing is void even if an adequate or market price was paid, or that the terms were fair, or that the trustee himself acted in a bonafide way.

establishing a corporate regulator and prudential regulator (a question considered more fully in Chapter 7). Bangladesh could adopt the Indian provident fund model in its current form. This would be a relatively straightforward extension of the present Bangladeshi system.

However, the author argues that there are real advantages at this point in time in Bangladesh considering an independently regulated trustee to administer trust funds. There are two main reasons for this. Firstly, the separation of government in some way from control of the fund, however minimalist at this stage, is desirable for improving its administration and knowing how to regulate the fund so that it can be expanded in the future. This means adding the third pillar – voluntary contributions. Secondly, the independence of a trustee from government control will ensure that funds when invested internationally will provide greater returns for the people who have contributed to them. The foundation stones for an independent trustee include a separate and distinct trust fund, the trustee's unfettered discretion in the exercise of trust powers and the trustee's fiduciary duty to beneficiaries. A more difficult question will be whether Bangladesh is ready to accept broader trustee powers of investment.

In the author's empirical research, interviewees agreed that it would be best to ensure that the trustee is separate and independent of government and independently regulated. Interviewees appreciated the need for the government to oversee change, but that change was required because of the unpredictability of a pension fund administered by the government and subject to different government rules each time the government changed. It was felt that the trust fund should be established securely for the future, with the fund assuming greater independence over time. In the earliest stages of development the trustee entity might comprise a mix of senior government personnel, private persons, and either national or international investment experts.

With the development of the domestic market and the acquisition of appropriate experience by investment managers, these funds may be managed within the domestic market where both trustee and investment managers can invest the funds more freely. The government should assume the primary responsibility for regulating the trustee and fund managers within a suitable regulatory framework. It is anticipated that after a suitable period both public sector administrators and private funds managers in Bangladesh would acquire the necessary competence in trust fund administration and investment management to obviate the need for

continuing government control. Gradually, accessibility to a universally accessible national pension and provident funds might be established on solid foundations in Bangladesh, leading to investment in global financial markets.³⁷⁵

³⁷⁵ See Appendix A 1.3: Key Findings regarding the author's empirical research.

CHAPTER 7: REGULATORY FRAMEWORK FOR A UNIVERSAL PENSION FUND

7.1 INTRODUCTION

The final question asked by the author in this thesis was: how should Bangladesh ensure that any separate and independent trust fund is effectively supervised and regulated? In this chapter the essential features of such a regulatory framework to accompany the creation of a universally accessible pension fund in Bangladesh, are discussed. The preceding chapter argued that Bangladesh should establish a trust fund separated from government control with an independent trustee. By establishing a properly resourced corporate regulator and prudential regulator, Bangladeshi citizens are more likely to see their contributions better protected in times of political change and financial upheaval. Australia, India and Singapore all utilize differing degrees of government control and regulation in the administration and prudential supervision of pension funds.

People interviewed for the author's study confirmed that an independent trustee and reforms in Bangladeshi trust law were seen to be necessary, but that these developments should occur within a secure regulatory framework. Such developments were widely regarded by interviewees as vital to the future evolution of a universally accessible pension fund and its investment in the domestic and international markets. This chapter considers the best possible regulatory framework within which to develop a universally accessible pension fund. Chapter 7 will focus on the optimum regulatory framework and the ways in which the government and people of Bangladesh could effectively supervise a successful pension fund system.

In this chapter also, the author suggests that modifications to Bangladeshi corporate laws and regulations may be required to help reform the country's pension funds. The Indian model for the regulation of its fledgling fund, which involves a single corporate-style regulator, may serve as an initial model for Bangladesh. However, in the longer term, the general prudential regulation for all banks or Authorised Deposit Taking Institutions (ADIs) by a regulator such as APRA in Australia may have valuable lessons for both India and Bangladesh.

7.2 GOVERNMENT CONCERNS FOR PENSION FUND REGULATION

Presently, no regulatory framework exists to require either that government or private employers to invest contributions to pension and provident funds so that a viable commercial rate of return eventuates for employees. As was mentioned earlier in this study, the existing Bangladeshi *Trusts Act* of 1882 prohibits the investment of the trust fund and limits the amount to be invested at only 25%, which is a serious impediment for contributors and fund managers in the domestic and global markets. The government's view appears to be that this limitation is necessary to ensure the balance of the fund is safe and secure. It is evident that the government lacks faith in nascent institutions and trust administration and regulations. However, a more liberal view of the investment of trust funds has evolved in many countries and the benefits of diversified investment and funds management by specialist institutions are better understood.

The WB, ADB and IMF all noted these major deficiencies in the Bangladeshi legal and regulatory system and administrative practices. Alongside the independent trustee, consideration must be given to suitable regulatory bodies that are empowered to monitor the trustee to protect and safeguard funds for the benefit of beneficiaries; the development of investment practices also need to be monitored. Essentially, the rate of return must not be subject to the discretion of employers, but must be soundly based on the rate of return derived from either national or international investments in normal market conditions. For these reasons, an independent trustee is necessary so that it is operationally separate from employers. This will ensure that all employees in the public and private sectors have their pension and provident fund contributions safeguarded.

At the outset of this consideration of a suitable regulatory framework for Bangladeshi pension and provident funds, the author notes the first steps taken by India in having separate pension and provident funds administered and overseen by a trustee.³⁷⁶ This chapter makes the important point that the Indian trustee is not independent of the government.³⁷⁷ The Indian legislation requires all pension funds managers to be licensed, regulated and supervised by the PFRDA, which provides the investment guidelines for individual subscribers and fund managers. India's example could be adopted in Bangladesh to some degree. An important first step is for the Bangladeshi Pension

³⁷⁶ Subhedar, S (2004), note 217.

³⁷⁷ Asher, Mukul G, and Nandy, A (2006), note 200.

and Provident Funds to be independent of government control. In time, both India and Bangladesh might move towards a general prudential regulatory framework for all banks and ADIs as Australia has done.

7.3 IS THE INDIAN REGIME A BLUEPRINT FOR BANGLADESH?

India's development of a pension fund has made great strides and it could serve as a blueprint for Bangladesh. The WB, ADB and IOPS have endorsed the establishment of a similar body such as the PFRDA to operate in Bangladesh, so that it can administer the trust fund whilst continuing to gather and develop relevant expertise. The system now prevailing in India bears some resemblance to the Australian system as it was in 1997. The Australian system was the subject of the Wallis Inquiry into the financial system, which led to reforms such as the formation of the APRA.

The author argues that in the longer term, it is worthwhile understanding how the Australian prudential regulation has evolved since the implementation of the Wallis reforms. The evolution of APRA within the Australian financial system suggests that, in time, the prudential regulator in Bangladesh could perhaps have general responsibility for the prudential oversight of all financial institutions and enjoy a greater degree of independence from the government than PFRDA in India does. The author suggests that both Bangladesh and India could benefit from how Australia's financial system has evolved, adopting similar prudential regulations for pension funds, mutual funds and similar prudential trust administrative practices.

7.4 THE INDIAN REGULATORY FRAMEWORK

India's SEBI operates to regulate that country's financial markets and to provide guidelines and regulations for many mutual funds. As mentioned previously, in 2004 the government of India set up an independent and separate regulatory authority called the PFRDA, to regulate and supervise the pension funds, including developing the pension regime in India. Similar to Australia's APRA, the PFRDA provides investment guidelines for individual subscribers and fund managers. Since the SEBI and the PFRDA form the apex of the regulatory bodies operating

in India, this section will now discuss India's banking, securities, and insurance and pension funds in terms of how they are regulated, beginning with the SEBI.

The SEBI was established by the *Securities and Exchange Board of India Act, 1992*.³⁷⁸ This Board protects the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected with investment and securities. The SEBI functions in a similar way to the U.S. SEC.³⁷⁹ The SEBI is relatively new but is a vital component for regulating and improving the quality of the financial markets in India. Improvements focus on two areas of administration: attracting foreign investors and protecting Indian investors. The ultimate purpose of the SEBI is to maintain stable and efficient markets by creating and enforcing regulations in the market place.

Because there is no comprehensive legal framework in India that regulates various categories of non-retail private pools of capital such as private equity and real estate funds, registration of trust funds with the SEBI is not mandatory. On the other hand, unregistered funds are not subject to investment restrictions applicable to registered venture capital funds (VCFs). The author draws from the recently released (2011) draft by the SEBI concerning Alternative Investment Funds Regulations, which address how India might eliminate the regulatory gaps and create a level playing field in its financial market. This may provide an example for how Bangladesh could achieve a level of expertise in developing its own trust fund and corporate framework.

The SEBI regulates business conducted on the Indian Stock Exchange and other securities markets. It registers and regulates stockbrokers, sub-brokers, share transfer agents, bankers, trustees, share registrars, merchant bankers, underwriters, portfolio managers, investment advisers and other such intermediaries who work in the securities markets industry. The SEBI also provides services for registering and regulating the work of depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and other intermediaries.

³⁷⁸ This Act was passed by the Indian Parliament in 1992, No. 15 of 1992, 4th April.

³⁷⁹ See Investopedia. <<http://www.investopedia.com>>.

The SEBI Board has the same powers as those vested in a civil court under the *Code of Civil Procedure*, 1908 (5 of 1908), with respect to discovery, summoning and inspection of documents, and enforcing commissions. The SEBI can also regulate or prohibit the issue of prospectuses, offer documents or advertisements soliciting money for the issue of securities. It can regulate collective investment schemes and has the power to issue directions and investigations, and order the cessation of proceedings to protect the financial markets from manipulation.

7.4.1 THE PENSION FUND REGULATOR AND DEVELOPMENT AUTHORITY (PFRDA)

India has understood the need to undertake a systematic reform of its pension fund industry.³⁸⁰ For this reason it established a sustainable, contributory NPS for all its citizens, employed or unemployed. The NPS is a highly innovative and sophisticated financial product and its promotion and development is vital for: firstly, building a universally accessible pension fund throughout the country to achieve the twin objectives of providing old age income security to a vast multitude of India's ageing population in the informal sector; and secondly, providing for the long-term investment needs of the Indian economy. India's government set up the PFRDA to manage the NPS and ensure that pension fund management companies act transparently within a regulated framework. It aims to promote old-age income security. It helps to establish, develop and regulate the pension and provident funds system systematically. PFRDA balances the interests of stakeholders by ensuring that pension fund accounts are managed separately, that investments and returns abide by the guidelines and ensuring that the pension fund industry is transparent.³⁸¹

The PFRDA is responsible for ensuring that international best practices in pension management and investment occur. The PFRDA is technically well equipped to monitor the Indian social security system.³⁸² It ensures that the governance structure of the provident and pension funds are transparent and accountable to stakeholders by disclosing details of investment policies and how

³⁸⁰ Asher, M and Vasudevan, D (2004), 'Role of Pension Regulator', LKY School of Public Policy, National University of Singapore, Singapore.

³⁸¹ Chatterjee, T.B (2004) 'Retiral Benefits in the Existing Regulatory Scenario in India', ICICI Prulife Seminar, December 10-11, 2004.

³⁸² Asher, M and Nandy, A (2004) 'Governance and Regulation of Public Pension Schemes', LKY School of Public Policy, National University of Singapore.

well they perform. In this way PFRDA meets the criteria of the OECD Guideline on Pension Fund Governance.³⁸³ This Guideline states that pension funds should have appropriate control, communication, and incentive mechanisms that encourage good decision-making, proper and timely execution, transparency, and regular reviews and assessments.³⁸⁴ The PFRDA receives expert advice or appoints professionals where it lacks sufficient expertise to make decisions and fulfill its responsibilities.

The PFRDA is adequately regulated to invest the NPS pension funds of Indian citizens. It secures the correct institutional and functional approaches to carefully assess the prudent-person principles and objectives of pension funds diversification for investment. Seventeen of India's 27 states have started the process of transferring their employee pensions to the NPS which works as a long-term investment.³⁸⁵ Modern and effective risk management, industry-wide risk management standards for pension funds have been promoted following the establishment of the PFRDA.³⁸⁶ It is currently trying to adopt the rules framed by the Securities and Exchange Board of India for allowing mutual funds under its supervision. It is also looking for opportunities to work jointly with the insurance sector regulator, the IRDA, for developing a proper market for annuities.

7.4.2 THE INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY (IRDA)

The insurance sector of India is currently completely regulated and now it is being partly deregulated. It is governed by a number of legislative Acts. The *Insurance Act* of 1938 was the first statute governing all forms of insurance to provide strict state control over the insurance

³⁸³ Asher, M and Nandy, A (2005) 'Governance and Regulation of Provident and Pension Schemes in Asia', LKY School of Public Policy, National University of Singapore.

³⁸⁴ The OECD set up this guideline for the corporate governance structure of pension fund in 2002 and OECD member countries approved it in April 2005.

³⁸⁵ Report of the Committee to Review Implementation of Informal Sector Pension [CRIISP] (2010), New Delhi, F. No. 1/22/2010 PFRDA.

³⁸⁶ Guerard, Y (2005) 'Managing the Assets of Social Security Schemes', presented at Workshop on Social Security Policies organised by Policy Implementation Assistant Project of Canada, Halong, Vietnam, April 25-27, 2005.

industry.³⁸⁷ This framework is of great significance to Bangladesh because it emphasises the message that a separate regulator for the pension industry is vital.

Until 1999, there were no private insurance companies in India. The government then introduced the *Insurance Regulatory and Development Authority (IRDA) Act* in 1999 which was amended in 2002 to incorporate important changes. The IRDA is a national agency of the Indian government and its functions to deregulate the insurance sector and allow private companies to operate. The IRDA Act protects the interests of policyholders, regulates, promotes and ensures orderly growth of the insurance industry. The IRDA Board is a ten-member team consisting of Chairman, five full-time members and four part-time members. All these positions are appointed by the government with reference to Section 14 of the *IRDA Act*, which deals with the duties, powers and functions of this Authority subject to the provisions of this Act and any other law for the time being in force.

In 1956 the *Life Insurance Corporation Act* nationalised 245 insurance companies into one entity called the Life Insurance Corporation of India. In 1972 the General Insurance Business Act also nationalised about 100 general insurance companies into four companies, these being the National Insurance, New India Assurance, Oriental Insurance and United India Insurance. They had their headquarters in each of the four metropolitan cities. Foreign investment was also allowed but it was capped at a 26% holding in the Indian insurance companies. Investment policy in the Indian insurance market deals with a low cost pension scheme that was formed by the PFRDA on 1st April, 2010 to provide social security to the poorer classes so that a universally accessible pension fund could be developed.

In India the insurance companies offer the pension plans or retirement plans to help individuals in building a retirement fund.³⁸⁸ This is not the case in Bangladesh. On maturity, this capital is invested for generating a regular income stream, which is referred to as a pension or annuity. Pension plans or retirement plans are distinct from life insurance plans, which are taken to cover risk in case of an unfortunate event. There are some fundamental differences between life insurance plans and pension plans in that life insurance plans cover the risk of an unfortunate event.

³⁸⁷ Johory, A (2010), 'A Strategic Gain in Insurance' *Richer Data, Better Results*, Vol. VIII, No. 1, published by J. Hari Narayan on behalf of Insurance Regulatory and Development Authority (IRDA), Hyderabad, India.

³⁸⁸ Expert Group (2009), 'Investment Regulations for the New Pension System for the Informal Sector', February 17.

Pension plans on the other hand work in that if or when an individual survives beyond retirement age, that person will need to provide for him or herself.

There are four types of pension plans in India and these are cover, without cover, 'immediate annuity' and deferred annuity. The 'with cover' pension plans offer an assured life cover which secures the amount in case of a person's death. Under the 'without cover' pension plan, the amount built till date (i.e. net of deductions such as expenses and premiums unpaid) is given out to the nominees in case of an eventuality. There is no sum assured in this case. In case of immediate annuity plans, the annuity/pension commences within one year of the premium being paid (usually a one-time premium). The premium paid for the immediate annuity policy is also known as the purchase price.

Currently in India, very few life insurance companies offer immediate annuity plans. In case of deferred annuity, the annuity/pension does not commence immediately; it is 'deferred' up to a time, which is decided upon by the policyholder. For example, if an individual buys a pension plan with tenure of 30 years (also known as the 'deferment period'), then his annuity will begin 30 years hence. Deferred annuity premiums can be paid as a 'single premium' or as regular premium. Presently, most pension plans available are deferred annuity plans. All pension plans receive a tax benefit such as a deduction up to Rs 10,000 available under Section 80CCC of the Indian *Income Tax Act*, 1961 and the benefit of taxation of maturity payouts up to one-third of the maturity amount, if withdrawn, is treated as tax-free. Pension received on the remaining two-thirds amount is taxed as per the individual's tax rate.³⁸⁹ Consequently, both the insurance and pension fund industries are liberalising India's investment environment. The provision of these insurance and pension fund services, within such a regulatory framework, might be considered valuable in Bangladesh.

The pension products offered by life insurers in India are regulated and supervised by the IRDA. The IRDA regulates group pension and gratuity products offered by life insurers to the trustees of pension and gratuity funds. It is not envisaged that the IRDA should regulate pension and gratuity funds directly outside government control. Nonetheless, the government of India has encouraged

³⁸⁹ Staff Reporter (2006) 'All you wanted to know about pension plans', *India News*, Rediff India Abroad, 22 March <<http://www.rediff.com>>.

a fully-funded age income security system that emphasises the values of thrift and self-help. The government made the NPS mandatory for its new recruits, except those employed in the defence forces, from 1 January 2004. It then took steps for those who do not have a sufficient income to contribute to the fund under the NPS. That is why in August 2008 the government decided to offer the NPS to all citizens of India on a voluntary basis. Accordingly, the PFRDA is taking the necessary steps to enhance the existing infrastructure so that the NPS is available to all Indians. India's state governments have been at different stages of implementing the NPS as of 1 May, 2009.³⁹⁰ Most of them have shifted to the defined contribution-based new pension system at different times. This is a very good step for India because it extends the opportunities for citizens to participate in the national new pension scheme.

7.5 FUNCTIONS OF PENSION AND INSURANCE REGULATORS

The PFRDA provides more investment choices through India's pension funds. It has undertaken the challenges to provide safety and high returns from pension investments to contributors. It extends the coverage to as many people as possible and promotes financial literacy levels by educating the potential participants about benefits and advantages of saving for retirement. The PFRDA has shortlisted six private sector companies to manage pension funds for citizens other than government employees. The PFRDA has been operating the NPS for all citizens since 2009.³⁹¹ The NPS for government employees is currently managed by three public sector institutions, specifically the Life Insurance Corporation (LIC), State Bank of India (SBI) and UTI Asset Management Company (UTI-AMC).³⁹² The NPS is a voluntary scheme where the individual contributor is given a permanent Retirement Account Number (PRAN). Contributors' records are managed by a central record keeping agency. The PFRDA has appointed a custodian and a trustee of the NPS assets.³⁹³ Furthermore, the NPS allows every citizen to save for

³⁹⁰ Press Release, Pension Fund Regulatory and Development Authority (PFRDA), April 30, 2009 <<http://www.pfrda.org.in>>.

³⁹¹ NPS has been operated by PFRDA since April 1 2009.

³⁹² Pension Sector (2009), *Hindu Business Line*, India, Vol. 2, p. 7.

³⁹³ Asher, M.G. and Vasudevan, D. (2006), 'Reforming India's Social Security System for the Twenty-first Century', National University of Singapore, June.

retirement within a regulated framework and it helps in promoting the growth of pension investment in India.³⁹⁴

The IRDA acts to safeguard the interests of insurance policyholders, as well as to initiate different policy measures to help sustain growth in the Indian insurance sector. To date this Authority has issued 27 regulations on various issues including registration of insurers and insurance agents, solvency margin, re-insurance, obligation of insurers in the rural and social sectors, investment and accounting procedures, protection of policy holders' interests, etc. The IRDA issued the Protection of Policyholders Interest Regulations 2001 where proposal documents had to be given to customers in easily understandable language, and where procedures for life and non-life insurance policies, grievances and settlements could be more efficiently expedited. These Regulations also provide for payment of interest by insurers if there are delays in settlements of claim. The insurers are required to maintain solvency margins so that they are in a position to meet their obligations towards policyholders with regard to payment of claims.³⁹⁵ In addition, the IRDA promotes fairness, transparency and orderly conduct in insurance matters and has built a reliable management information system to enforce high standards of financial soundness amongst market players. It also takes action where such standards are inadequate or ineffectively enforced. The IRDA enforces the best self-regulation practices in day-to-day operations in collaboration with the insurance and pension industries.³⁹⁶

Within India's regulated insurance industry, insurance companies are obliged to disclose clearly the benefits, terms and conditions of their policies. Advertisements issued by the insurers should not mislead the public. All insurers are required to set up proper grievance redress machinery in their head and branch offices. The IRDA takes up with the insurers any complaint received from the policyholders in connection with services provided by them. The Indian government instituted the Insurance Ombudsman on 11th November 1998 and its job is to assess the

³⁹⁴ Staff correspondent (2005), 'The Route to Real Pensions Reform', *The Economist*, Delhi, January 6.

³⁹⁵ S14 of *IRDA Act* 1999 deals with the duties, powers and functions of IRDA.

³⁹⁶ Murthy, J. D and Kamagala, M. V (2010), 'Preventing Insurance Fraud', Vol. VIII, No. 8, published by J. Hari Narayan on behalf of the Insurance Regulatory and Development Authority (IRDA), Hyderabad, India.

grievances of insured customers and mitigate their problems. This department is of great importance in building people's confidence in the system.³⁹⁷

India's regulatory system is currently in a transitional or intermediate stage of development in which the trustee may eventually become more independent. For the moment, however, the trust concept is being loosely used in that India has not yet created an independent system of trustees and regulatory framework. Nonetheless, Bangladesh could employ India's system of a transition to trusteeship and independent regulation. As we shall see below, an examination of the Australian regulatory system shows a more developed framework which in the author's view, may be the type of framework that both India and Bangladesh could adopt.

7.6 AUSTRALIAN REGULATORY FRAMEWORK

In Australia the Wallis Committee Report resulted in the establishment of two primary regulators - ASIC and APRA. A corporation providing a financial service, which includes a trustee administering superannuation funds, must be licensed by the ASIC and comply with the policies and regulations of the APRA. This also applies to any type of government agency in Australia's federal government system. Both the ASIC and the APRA are independently established government authorities which act as Australia's corporate and prudential regulators, by overseeing and ensuring those deposit and superannuation funds are held for the benefit of the contributors, and not for the private use of trustees.

7.6.1 ESTABLISHMENT OF THE APRA

APRA³⁹⁸ is the national regulator of prudential institutions, for example deposit takers, insurance companies, and superannuation funds. The Wallis Committee, in handing up its final report to the federal government, at the conclusion of undertaking a financial system inquiry in 1997, recommended and proposed the Authority be created. The APRA was established on 1 July 1998.

³⁹⁷ Johory, A (2010), note 371.

³⁹⁸ Australian Prudential Regulation Authority, Submission to the HIH Royal Commission, cited in 'The failure of HIH Insurance', *The HIH Royal Commission*, 2003, p. 201.

Federal Parliament passed the *Australian Prudential Regulation Authority Act, 1998* (the *APRA Act*) to ensure that prudentially regulated financial entities maintain a minimum level of financial soundness.³⁹⁹ Collectively, corporate regulators protect superannuation industry consumers, investors and creditors by ensuring that companies and financial institutions adhere to company and competition law.⁴⁰⁰ The APRA has a prudential responsibility to administer the provisions of the *Superannuation Industry (Supervision) Act 1993*, and associated regulations. Since 30 June 2006, all trustees of the APRA-regulated superannuation entities are licensed. Licensees are encouraged to have appropriate risk management systems and plans for funds under their trusteeship.⁴⁰¹

7.6.2 PRUDENTIAL REGULATOR UNDERTAKEN BY APRA

The APRA is the prudential regulator of Australia's financial services industry. As such, it oversees banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies, and other players in the superannuation industry. The APRA currently supervises institutions holding approximately \$3.7 trillion in assets for 22 million Australian depositors, policyholders and superannuation fund members. The APRA⁴⁰² is a statutory body and like the ASIC, was established to regulate the financial services industry. However, where the ASIC primarily focuses on market integrity and investor and consumer protection, including licensing and monitoring financial services businesses to ensure they operate efficiently, honestly and fairly, the APRA is responsible for the registration of those financial corporations it oversees.

The responsibilities of Australia's financial regulators have never been greater. At one level, this is reflected in the legislative and administrative changes that have strengthened the architecture of financial regulation. These developments in turn reflect the growth and dynamism of financial institutions, the high proportion of Australian citizens active in these markets, governments'

³⁹⁹ See APRA Report 2004, <<http://www.comlaw.gov.au/Search/CA2004A00310>>.

⁴⁰⁰ Perkins, J. *The Wallis Report and the Australian Financial System*, Melbourne University Press, Melbourne, 1998, p. 18. The *Financial System Inquiry* is available at <<http://fsi.treasury.gov.au/content/FinalReport.asp>>.

⁴⁰¹ Wilson, S., Chris, I., Neil Esho, and Sane, R (2008) Superannuation fund governance: trustee policies and practices, A working paper version (with attachment) of the article was published in *APRA Insight* Issue 1 7 July, 2008.

⁴⁰² See Australian Prudential Regulation Authority, <<http://www.apra.gov.au/Pages/default.aspx>> and Parliamentary Library, <<http://www.aph.gov.au/LIBRARY/Pubs/bd/1997-98/98bd203.htm>>.

promotion of the superannuation industry, and the risks for investors, depositors and creditors. The APRA's regulatory strategy substantively differs from the ACCC and ASIC in that its emphasis is on supervision rather than enforcement. Its brief is not to prosecute companies but to ensure their financial health by protecting depositors, policyholders and superannuation fund members. The ASIC's regulatory mindset is 'enforcement supported by education'; the APRA's focus is 'supervision supported by enforcement'.⁴⁰³

The APRA is therefore primarily a supervisory agency and its principal aim is to ensure that financial promises made by regulated entities are met within stable, efficient and competitive financial markets. The APRA does this by seeking to ensure that the quality of a financial institution's systems for identifying, measuring and managing the various risks in its business (including, for example, adequacy of capital) are sound and act to reduce the risk of failure. When failure does occur, the APRA works to maintain public confidence in the financial system, by helping the failing entity make an orderly exit from the market.

To enable its supervisory role, the APRA operates under a broad legislative framework, which allows it to interact widely with the industry that it oversees. Under s 9 of the *APRA Act*, the APRA is empowered to function with whatever functions are conferred on it by or under the Act, or any other law of the Commonwealth, or to function according to functions conferred on it by or under any law of a State or Territory in accordance with the *APRA Act* sub-sec 9A(1), or to function according to the function of providing prudential regulation or advice services under agreements entered into in accordance³ with sub-sec 9A(2).⁴⁰⁴ Both sub-secs 9A (1) and (2) permit the APRA to enter into ministerial approved agreements with the states or territories for providing prudential or regulatory advice services within the Commonwealth's legislative remit. Additionally, under s 11 of the *APRA Act*, the APRA has the power to do anything that is necessary to be done for or in connection with the performance of its functions.⁴⁰⁵

⁴⁰³ Australian Prudential Regulation Authority, *APRA Insight*, 3rd Quarter 2004, p.18, at <<http://www.apra.gov.au/Insight/Insight-3rd-Quarter-2004.cfm>>.

⁴⁰⁴ See *APRA Act* <http://www.austlii.edu.au/au/legis/cth/consol_act/apraa1998477/s9.html>.

⁴⁰⁵ See *APRA Act* <<http://www.apra.gov.au/AboutAPRA/Pages/Default.aspx>>.

7.6.3 APRA'S POWERS

The APRA has three main types of powers in regulating financial institutions: authorisation or licensing powers; supervision and monitoring powers; and powers to act in circumstances of financial difficulties to protect depositors, policyholders and superannuation fund members. IT also has powers relating to taking control of entities and/or winding up insolvent entities. Australia has two unique features in its financial sector regulation model.⁴⁰⁶ These are sometimes referred to as the 'twin peaks' regulatory structure⁴⁰⁷ wherein APRA is empowered to take a functional approach. This approach to regulation originated in the *Financial Services Reform Act, 2001* (Cth) (the *FSR Act*), the legislative objective being to regulate by reference to the function of the financial arrangements rather than its institutional or legal form. This created a single licensing regime for financial sales, advice and dealings in relation to financial products, including financial product disclosure.

Similarly the *Corporations Act, 2001* (Cth) (the *CA*) extends the reach of many parts of the securities laws by operation of Pt 2 Div 2 Ch 7, which applies to other financial products not thought of as being subject to the securities regulation. Financial products caught in the regulatory net include various forms of financial investments either listed or unlisted, and financial arrangements used to hedge against risk as part of strategies of treatment of risk management in the financial sector,

Although the above objectives are self-explanatory, there are exemptions under the *CA* which alleviate certain persons or entities from the requirement to hold an Australian financial services license for the provision of financial services which are provided under *CA* s 911A(2), and the relevant *Corporations Regulations* (the *CR*).⁴⁰⁸ The author does not intend to explore this area of exemptions and only makes a passing mention for the sake of awareness that the exemption exists. Suffice to say, that corporate regulation is administered in Australia by both the APRA and the ASIC, which have at their disposal mechanisms for imposing regulation including prohibitions on market fraud, disclosure to the market and corporate governance.

⁴⁰⁶ Robert Baxt, Ashley Black, Pamela Hanrahan, *Securities and Financial Services Law* (7th ed, 2008), LexisNexis Butterworths, Australia, pp. 5-7.

⁴⁰⁷ See Australian Prudential Regulation Authority <<http://www.apra.gov.au/Pages/default.aspx>> and Parliamentary Library <<http://www.aph.gov.au/LIBRARY/Pubs/bd/1997-98/98bd203.htm>>.

⁴⁰⁸ Baxt, R., Black, A, and Hanrahan, P (2008) *Securities and Financial Services Law*, LexisNexis Butterworths, Australia, 7th ed, pp. 469-473.

7.6.4 EVOLUTION OF A SEPARATE CORPORATE REGULATOR (ASIC)

The ASIC is Australia's corporate, market and financial services regulator. It regulates a current total of 1.5 million either publically listed or private corporations, which includes 4,415 financial services businesses. It also regulates 15 financial markets. ASIC seeks to ensure that Australia's capital and financial services markets are fair and transparent, supported by confident and informed investors and consumers. Historically, after a number of disputes between the Commonwealth and the states and territories, in-principal agreement was reached in 2000 between them regarding how corporations operating in Australia would be referred to the Commonwealth, including the power to amend legislation. Under s 51(xxxvii) of Australia's Constitution, the Commonwealth has the power to deal with such matters referred by the states to it.

However, the states - together with the Commonwealth - agreed that the referral would have a sunset clause to allow a state to terminate it after five years. Subsequently, the Commonwealth passed the *Corporations Act, 2001 (Cth)* (the *CA*) and the *Australian Securities and Investments Commission Act, 2001 (Cth)* (the *ASIC Act*), which replaced the previous legislation regulating companies and corporate entities.⁴⁰⁹ The *CA* came into effect on 1 July 2001 and it applies to all of Australia's legal jurisdictions. If one of the states were to now terminate its reference, the *CA* will still apply in the remaining referring states. Nationally, the *CA* is administered and enforced by Commonwealth enabled entities such as ASIC.⁴¹⁰

Before 1998 the ASIC was known as the Australian Securities Commission (ASC), and as well as changing the Commission's name, the ASIC was further empowered with additional functions to deal with aspects of insurance and superannuation regulation, including market integrity and consumers protection. These additional functions were strongly recommended by the 1997 *Financial System Inquiry Final Report* (i.e. Wallis Committee Report). Upon coming into force in 2001, both the *CA* and the *ASIC Act* formed a single Commonwealth law that now operates in all states and territories.⁴¹¹

⁴⁰⁹ Australian Prudential Regulation Authority (1997-8), note 408.

⁴¹⁰ Phillip. L, and Herzberg, A (2008) *Understanding Company Law*, 14th ed, Law Book Co., Australia, pp. 10-11.

⁴¹¹ Phillip. L, and Herzberg, A (2008), note 393.

The ASIC is responsible for regulating financial products services and markets. The ASIC also provides appropriate licensing for operating in the financial market to the Australian Stock Exchange. In relation to the fundraising provisions of the Commonwealth of Australia, the ASIC has the power to grant exemptions to this requirement.⁴¹² One of the important roles played by the ASIC is in regulating company takeovers. A targeted company is required to submit to the ASIC its statement giving prescribed information about financial transaction. Then the ASIC ensures that shareholders of the target company are provided with adequate information to allow for an informed decision to be reached in relation to the merits of the takeover. ASIC may, under its broad powers, exempt or modify the application of the takeover bid. In the interests of fairness that the takeover provisions are complied with, under *CA* Pt 6.10 Div 2, ASIC or any person whose interests are affected by the ASIC's decision, or by unacceptable circumstances, may apply to the Takeovers Panel for an order affecting the ASIC's decision, or in relation to the shareholdings apply for a declaration that unacceptable circumstances have occurred.⁴¹³ In ensuring compliance with the provisions of the *CA*, the ASIC can investigate and gather information where a contravention is suspected of having been committed. This can include compelling persons to give reasonable assistance, answer questions on oath, and produce books and records in broad circumstances, bring legal proceedings in the public interest, including the power to intervene in any legal proceedings in relation to matters arising under the *Corporations Act*.⁴¹⁴

Given its wide corporate and financial markets regulatory role, the ASIC has general powers to protect consumers against misleading or deceptive and unconscionable conduct affecting all financial products and services, including credit and, along with other regulators, administers aspects of legislation relating to insurance, superannuation and retirement savings accounts. As mentioned above, the ASIC's approach to regulation is largely risk-based. This means that the ASIC focuses on areas that it assesses as being of the greatest risk, such as misconduct and non-compliance that affect consumers' decisions, threaten the reputation of our markets or undermine

⁴¹² Phillip, L, and Herzberg, A (2008), note 393. See also Australian Securities and Investments Commission, <<http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Our%20role>>.

⁴¹³ Cooper, J (2006), 'The integration of financial regulatory authorities – the Australian experience: Assessing the Present, Conceiving the Future' 30th Anniversary Conference, 4-5 September, Rio de Janeiro, Brazil.

⁴¹⁴ *ASIC Act* Pt 3 s 19, s 50; *CA* s 1330 and see Phillip, L and Herzberg, A (2008), note 393.

Australia's international reputation as a safe, well-regulated place to do business. It then decides what available regulatory tools best deal with those risks.

The ASIC identifies areas where new risks might emerge, or where existing risks could have a larger impact. To help with this task, ASIC regularly consults with the industry and consumers. To strengthen its consultative activities, the ASIC announced the establishment of a Business Consultative Panel in July 2011.⁴¹⁵ Participants on the Panel are senior business leaders and they reflect a wide cross-section of the Australian business community. The Panel provides a forum for more effective and open dialogue between the ASIC and the business community on current and emerging market issues and risks. The ASIC also has a Consumer Advisory Panel that was established in 1998, and its function is to advise the ASIC on current consumer protection issues, research and education projects and give feedback on its policies and activities.⁴¹⁶

7.6.5 ASIC'S POWERS

The ASIC has wide-ranging powers which include being able to investigate situations where a breach of its legislation may have occurred.⁴¹⁷ It has the power to apply for a civil penalty order and accept and enforce an undertaking to comply with the law. It can also apply to the Takeovers Panel and disqualify people from managing corporations or dealing in financial services. Section 51 of the *ASIC Act*, gives the ASIC the power to hold hearing for the purposes of the performance or exercise of any of its functions and powers. In certain circumstances the *Corporations Act* requires the ASIC to hold a hearing, for example if the ASIC wants to make a stop order where it is satisfied that a disclosure rule has been breached in so far that a disclosure document contains misleading or deceptive statements in contravention of *CA* s 728, the ASIC must hold a hearing and give any interested person a reasonable opportunity to make submissions on whether the order should be made.⁴¹⁸

Under the Section s 52 of the *ASIC Act*, the ASIC may hold the hearing in public or private but in doing so, the ASIC must consider the confidential nature or otherwise of the matter, including the

⁴¹⁵ Phillip, L and Herzberg, A (2008), note 411

⁴¹⁶ Phillip, L and Herzberg, A (2008), note 411.

⁴¹⁷ S. 13 of the *ASIC Act*.

⁴¹⁸ The Australian *Corporations Act*, s 739(2).

public interest. Otherwise, a hearing must be held in private if required by the corporation's legislation.⁴¹⁹ Members of the ASIC have powers to summon persons to attend a hearing and to give evidence or produce documents.⁴²⁰ However, hearing procedures are conducted with as little formality and technicality as possible.⁴²¹ As such a hearing, the ASIC is not bound by the formal rules of evidence but is required to observe the rules of natural justice due to it exercising an administrative function and not a judicial function. Because the ASIC's hearings are of an administrative function, it can reopen a hearing after receiving fresh evidence per *Boucher v ASIC*.⁴²² The ASIC may also bring class actions in civil proceedings where it appears as a result of an investigation or examination that it is in the public interest to do so.⁴²³ It may initiate the action for the recovery of damages for fraud, negligence, default, breach of duty or other misconduct committed in connection with a matter in relation to an investigation or examination it has conducted.⁴²⁴

Although the Australian prudential system has been utilised in this thesis as a benchmark example for Bangladesh, it must be remembered that the Australian prudential system has failed on occasions, notably in failing to act promptly shortly after it came in to being in the case of HIH Insurance. This is a timely reminder that any prudential or other regulatory system is always subject to failings caused by poor administration, structural inadequacies and errors of judgment by those involved. However, Bangladesh might utilize and benefit from the experience of Australia while also ensuring that the administrative culture and regulatory framework remains generally healthy.

7.6.6 ASIC'S ENFORCEMENT APPROACH

The ASIC faces numerous challenges including keeping up with a rapidly evolving and complex financial system, and balancing business facilitation with consumer protection. To maintain public confidence in companies, financial markets and business offering financial services, the

⁴¹⁹ *ASIC Act*, s 54.

⁴²⁰ *ASIC Act*, s 58.

⁴²¹ *ASIC Act*, s 59.

⁴²² Phillip, L and Herzberg, A (2008), note 393, p. 584.

⁴²³ Phillip, L and Herzberg, A (2008), note 393.

⁴²⁴ *ASIC Act*, s 50.

ASIC acts effectively and quickly against fraud, dishonesty and misconduct. Although a ‘heads-on-pikes’ measure is not entirely reflective of the ASIC’s ability to achieve this objective, it does provide at least one metric. In the 2005-06 financial year the ASIC had 27 criminals convicted, completed 102 civil proceedings and commenced 195 criminal, civil or administrative proceedings against 391 people or companies. Some 43 directors were banned from managing corporations for a total of 195 years. The ASIC also acted against 102 illegal fund-raising schemes involving some 5,000 investors and in excess of US\$590 million.

7.7 WHY A CORPORATE REGULATOR IS NEEDED

The aim of any regulation and supervision is to protect the subscribers and consumers of various products and services. A corporate regulator is required for enforcing the same rules to the companies and financial institutions so that their operations are being carried out profitably and efficiently. Such a regulator ideally will secure honest and fair treatment to the customers.

Prudential regulation is preventative in nature, in that it is directed largely at preventing promissory breach through financial failure. In recognition that no system of preventative regulation is perfect in all circumstances, the Wallis Committee Report found that prudential regulation must also deal failures when they occur. It was further recognised that any regulatory assurance should be tightly balanced with the view that it is ultimately the management, and the board of a financial institution, which must ensure that its businesses deliver on the promises made. The Wallis Report determined that it is not appropriate for a government to underwrite them. Although prudential regulation adds an extra layer of oversight beyond regulation of disclosure and conduct, this fact should not be construed to be a guarantee by the government of the day against any impropriety on the part of the mismanagement by a financial institution’s management and board.⁴²⁵

The real prosperity of nations is based on free and competitive markets, resulting from an efficient allocation of resources, economic growth and development. Into this mix, governments play a pivotal role in maintaining a healthy economic and social environment in which national wealth is realised – where enterprises and consumers interact with confidence. Market failure

⁴²⁵ Stan Wallis (Chairman), *Financial System Inquiry Final Report – March 1997*, Commonwealth of Australia 1997, Australian Government Publishing Service, p. 300.

produces the strongest case for regulation which aims to reduce the outcomes of inefficient or dangerous market practices. However, although the potential for market failure may be ever-present, it is not a substantive reason for a government to intervene in the market. The best way to provide effective regulation of the market place is to enforce a consistent legal framework which clearly identifies what needs to be regulated, and why.

The Wallis Report considered what this would mean in terms of regulation for financial safety and social objectives. The Wallis Committee investigated the economic function of financial markets and institutions in facilitating the exchange of financial contracts, because financial contracts played a fundamental role in efficient functioning of trade and commerce – e.g., a promise to make payments at specified times, in specified amounts and in specified circumstances. These also included trusts where promises are made to manage assets in the best interests of beneficiaries. The Wallis Report concluded that financial institutions have evolved into two main forms: firstly, intermediaries such as banks and insurance companies which transact promisors and promises on their balance sheets; and secondly, fund managers and other agents, which act to bring promisors and promisees together in the market place. Those underlying promises contained within financial contracts are targeted by regulations aiming to ensure that the financial instructions and financial markets do as they promise.⁴²⁶

A further case for financial regulation arises from the risks attached to financial promises. The financial system functions efficiently when risk is well managed, allocated and priced. Where promises are characterised as being inherently difficult to honour or there is difficulty in assessing the creditworthiness of promisors, and adversity is caused by promises being breached, this causes market failure. It can be summed up in two ways such as risk to third party losses due to systemic instability, and lack of information available to most consumers, without which they cannot reliably assess risk, and in particular the creditworthiness of the promisor.⁴²⁷

Controversially, the Wallis Report argued against financial institutions having ‘community service obligations’. The Report maintained the view that financial institutions, like any other business, are created to create wealth, not redistribute it. However, the Report did say that the needs of the disadvantaged in society should not be entirely ignored, but nonetheless the federal

⁴²⁶ Stan Wallis (Chairman), note 384, pp. 178-180.

⁴²⁷ Stan Wallis (Chairman), note 384, pp. 188-9.

government ought not to regulate financial institutions to undertake social responsibilities for which they were not originally created. In a competitive market, to require financial institutions to subsidise certain social activities would compromise their efficiency and ability to be commercially unsustainable. Where there are social concerns, the Wallis Report asserted that these were more effectively and efficiently dealt with through direct government funding, transfer of payments or provision of services.⁴²⁸

The author contends that the Australian regulatory experience provides an important insight into the possible shape of the regulatory regime that might ultimately evolve in both Bangladesh and India.

7.8 CONCLUSION

After many years of development, Australia has implemented independent corporate and prudential regulators (ASIC and APRA). India on the other hand, has adopted separate but not yet fully independent corporate regulators. Bangladesh has established both the SEC and the Insurance Regulatory Authority (IRA), which are equivalent respectively to ASIC in Australia and IRDA in India. To date, however, Bangladesh has not sought to establish any dedicated regulator of pension funds (such as PFRDA in India). Nor has it sought to establish any general prudential authority such as the APRA in Australia empowered to oversee the financial system generally.

These institutions have much to teach Bangladesh about the way forward in developing a well-regulated pension fund. While India's system is in transition it does share with Bangladesh a similar administrative and cultural heritage, and for this reason Bangladesh might begin with a close consideration and the possible adoption of a dedicated pension fund and insurance company regulator. The author is of the view that this may be an essential step for Bangladesh in building its regulatory system - in order to address criticisms made by the WB and ADB concerning the country's underdeveloped and under-regulated nascent institutions. In the longer term, the Australian experience suggests that a more broadly based system for the prudential regulation of financial institutions generally in Bangladesh may be the ultimate result in pursuing this path to

⁴²⁸ Stan Wallis (Chairman), note 384, p. 195.

follow. In the meantime, however, a dedicated pension fund regulator such as PFRDA in Bangladesh should be developed and having similar powers as possessed by APRA in its role of prudential regulator.

CHAPTER 8: RECOMMENDATIONS

In the light of the conclusions reached in Chapters 6 and 7, the author makes the following particular recommendations to the Bangladeshi government and senior policy-makers seeking to advance the three-pillar pension framework recommended by the WB. This framework comprises a publicly unfunded DB pillar, a privately funded DC pillar, and a voluntary pillar.

The government and senior policy-makers might consider the establishment of a new fund separate from the publicly funded Provident Fund but remaining under the continuing close supervision of the government. The fund might be administered initially by a corporate trustee which could in time assume control of the fund independently of government and be accountable to its members and the government through the supervision of independent corporate and prudential regulators. In this respect Bangladesh might consider the adoption of a dedicated pension fund regulator such as PFRDA in India. Such a regulatory body might also begin to assume some of the powers of a more general prudential regulator such as APRA in Australia.

A critical element in ensuring the value of the new fund in Bangladesh would be the accessibility of the fund's benefits to the unregistered sector which includes a great number of self-employed workers who lead an essentially hand-to-mouth existence and have no real income or savings. At the present time, this group does not receive public welfare benefits. As self-employed citizens they do not strictly qualify for participation in a standard pension fund scheme and would be unable to make voluntary contributions in accordance with the third pillar. Nevertheless, the establishment of a more accessible pension fund in Bangladesh must consider the ways in which the new pension fund is to benefit this disenfranchised group of citizens. One possibility might be to extend the reach of the new fund to permit contributions by self-employed workers and the government to a publicly administered fund. In this respect, the co-contributory system administered by PFRDA in India may serve as a useful model.

Of course, these developments would need to be very gradual with close monitoring of what might work most effectively. It may be that the true independence of the corporate trustee from government is something that may take many years to achieve. In the meantime, there is much

experience to be acquired by the trustee both in its adoption of trust law and corporate governance practice, in its accountability to the government and regulators, and in its development of investment expertise.

Recommendations:

- The existing Provident Fund might be separately administered within government to more clearly reflect the responsibilities of an independent trustee and to emphasise the responsibility of the trustee or government to fund members' defined benefits and to invest the fund for the maximum benefit of fund members. Over time, the concept of a trustee capable of acting independently of government, when appropriate, in the interests of members may be developed. The natural consequences of this development over time may be greater accountability to members in investing the fund greater portability of the fund in the event of a change in employment. In achieving this result, specialized education and training for government officers and other employers involved in trust fund administration will be essential.
- In other autonomous bodies such as universities, banks and the Bar Council, in NGOs and in private corporations, it is recommended that a separate new trust fund be established with a corporate trustee comprising representatives of management and employees to administer the fund. These autonomous bodies presently do not have a separate and independent trustee so that employees' benefits are wholly dependent upon the available funds of the organisation. Importantly, the new trust fund established for these organisations must be subject to routine corporate and prudential regulation. In this respect, Bangladesh might usefully consider the role played by the PFRDA in India as a dedicated pension fund regulator and by APRA as a general prudential regulator of financial institutions in Australia.

- To provide for an independent trustee, and for the most effective commercial use and investment of pension funds by the trustee, the Bangladeshi government may need to revise and amend the *Trusts Act, 1882*.
- The Bangladeshi government might consider including insurance companies, which provide insurance and annuity products and services, within the regime of pension fund regulation. At the same time it is necessary to address the corporate practice of pension funds to ensure that insurance companies and annuity providers share pension-investment liability with the trustee.
- To achieve the full benefits deriving from the accumulation and investment of savings within the new pension fund, it would be necessary to examine and structure comprehensively the relevant income and taxation benefits for the fund and individual contributors (see Appendix B). To ensure that the different socio-economic groups (including particularly the self-employed poor) are able to contribute to and benefit proportionately from this fund the government might consider overseeing some arrangement, such as that adopted in India, for co-contribution to the fund.
- To achieve the full benefits of the new pension fund in the longer term development of domestic markets and raising capital, and to ensure maximum returns to fund members, it would also be necessary to develop investment expertise in the management of funds. As has been seen in this thesis, the law relating to the commercial investment of trust funds remains a vexed theoretical question in developed countries as much as it is a problem in developing countries such as Bangladesh. The issue should be considered at this point in Bangladesh. In practice, the issue might be approached by utilising a mix of strategic assistance from foreign experts and simultaneously training Bangladeshi nationals. It may be useful to improve education and public awareness of the incentives for investing the fund if the fund were to be strategically invested internationally with a view to generating high investment returns in the short term. Such an approach is adopted by Singapore. To do this, the fund might be invested under the close supervision of the government,

regulators and with the expertise of a highly trained advisory group of foreign and domestic investment managers.

APPENDIX A

AUTHOR'S EMPIRICAL RESEARCH

**EVOLUTION OF THE BANGLADESHI PROVIDENT FUND AND ITS
INVESTMENT: TOWARDS AN INDEPENDENT TRUSTEE**

Md. Shamim Alam

(Field Work in Bangladesh: December 2010 to February 2011)

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Evolution of the Bangladeshi Provident Fund and its investment: Towards an Independent Trustee.

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Part 1: Background, Methodology and Key Findings

1.1 Background

Appendix A of the thesis records the field work in Bangladesh. The results of an empirical study are drawn from interviews undertaken during this investigation of the ‘Evolution of Bangladeshi Provident Fund: A Springboard into World Markets’. An empirical research approach was prioritised and the schedule for this study was prepared during December 2010 to February 2011. A detailed description of the background of the study and methodology are provided in this appendix. Part 1 sets out the aims, significance and summary of the major findings, and valid reasons for undertaking a study of this nature.

It has long been recognised that pension and provident funds in Bangladesh are not structured sufficiently in a corporate manner to engage with the global financial community, benchmarked by Australia, United Kingdom and US pension markets. Pension markets are perceived as valuable monitors within a national corporate structure.⁴²⁹ The Bangladeshi pension and provident funds are subject to legal and practical impediments that compromise active institutional monitoring.⁴³⁰ Potential political influence exerted on pension funds may result in problems rebounding on the government of the day, yet in the long-term may have wide-ranging beneficial effects on Bangladeshi citizens. Implementing such a beneficial strategy will be challenging to any government in light of necessary and new political and corporate management regulations being established.

Large Australian and United States pension funds have dominated the international financial landscape since the 1990s. Instrumentally, they have been the leaders in setting corporate management, investment standards and codes of practice, including establishment of institutional shareholders standard voting policies. Bangladeshi citizens have yet to realise the same pension funds structure as employed in Australia and the United States. The structure as used in those

⁴²⁹ Lamoureux C, President and Chief Executive Officer of the Ontario Teachers’ Plan Board and Chair of a session titled ‘Which Shareholder Values are Valuable’ at the ICGN 2000 meeting. ICGN, *Corporate governance and Globalisation*, New York City, July 12-14, 2000.

⁴³⁰ Stapledon GP, ‘Disincentives to Activism by Institutional Investors in Listed Companies in Australia and the United Kingdom’ (1996) 18 *Sydney Law Review* 152-192.

countries is based on the concept of where the juncture of shareholders voting rights and corporate management meet. In practice, shareholders have strongly influenced corporate investment and the monitoring of corporate performance in relation to funds management. In Bangladesh, activity derived from this model would promote public awareness and greater shareholder interest in corporate issues and performance. The general benefit is that it will create sound corporate governance and a healthy financial economy.

When interviews for this study were undertaken during December 2010 and February 2011, Bangladeshi pension funds did not have a legal structure where appointed trustees, fund and investment managers were appointed. What currently is in place is a reliance on government employees to fulfill the role of the trustee, and likewise the fund and investment manager. This occurs because of a long-held government policy that it is the government which is entitled to play the role of the trustee, which is in proper terms a legal fiction. It is a legal fiction based on the fact that there is no separation between the government itself as the employer, and the government's employees' acting as the trustee. However, the government can be responsible as a quasi-trustee by appointing a separate and independent trustee body, which would report annually to the government on the performance of its funds under management.

The interviews revealed that currently in Bangladesh, most of the private sector has no provident fund for employees. Some of the autonomous sectors (Universities and Bar Council) and certain parts of the private sector do have a provident fund system, but what is completely missing is the independent trustee. It is the employer who handles the funds without appointing a separate trustee who has their own financial management strategy in relation to allocation of funds.

Unsurprisingly, both the private and government sectors in Bangladesh are appropriating and using the funds for their own needs, such as finding money for budget shortfalls, without the consent or authority of the contributors. However, there is no legal authority permitting the government to use the provident funds in this way. For example, if any government employee engages in misconduct, the government may take legal action to withhold the pension fund for distributing retirement benefits. However, the government is not entitled to stop the provident fund, because monies held within the fund belong entirely to the contributors. The issue then arises that if the provident funds belong to the contributors, how is it that government and private

employers can access the funds for their own use, even if it is stated by the appropriators that the funds will be used for the benefit of the contributors?

A second concern arises from the above scenario, and it consists of three issues, i.e. how the rate of return will be determined, the allocation of funds to be invested and how will the funds be managed, monitored and reported. What is known by the contributors is only the fixed rate of interest to be applied to the funds. This knowledge does not allow the contributors to make comparisons with investment options that occur in other developing countries. Unfortunately, the Bangladeshi *Trusts Act 1882* permits this errant behaviour to continue due to its inherent weakness which allows persons or institutions who are not trustees, to access trust funds. This behaviour epitomises a gross lack of corporate responsibility within the pension and provident funds trustee framework.

Currently, Bangladesh does not have properly regulated managed funds schemes within a sophisticated legal framework like Australia. This type of fund can lead to strong markets and investments, as laid down in Chapter 5C of the Australian Commonwealth's *Corporations Act 2001*. If Bangladesh was to marshal national savings through the universally accessible pension fund to all citizens, these could be used as a managed investment scheme under either the control of the government or private sector, or both.

1.2 Methodology

This study is an empirical and qualitative research based on grounded theory, literature, legislation, case law, international comparisons, documentary analysis, examination of reports and questionnaires. It also comprises empirical field work carried out in Bangladesh, in the form of face-to-face interviews with government and private sector employees and legal practitioners. Most of the interviewees in the government sector work in pension and provident funds management and administration. Academics, fund managers and legal practitioners were also interviewed for this study, and each provided significant experience in academic and legal matters, involving pension and provident funds entitlement.

The interviewees were grouped according to specific questions which related to their expertise and knowledge, including their availability to participate. To solicit the maximum responses, 35 questions were divided into three more specific areas of questioning, namely: 1) business structure, 2) legal structure and 3) pension and provident funds in the insurance industry. Interviews were then conducted with 25 individuals representing government, non-government, private and autonomous organisations. Most of those who participated in the interview process were contacted to obtain their views in relation to their work concerning pension and provident funds management and administration. Structured but open-ended individual interviews were conducted. At the conclusion of each interview, descriptive and qualitative results were compiled from personal notes taken by the two interviewers.

The fundamental objectives of the present study were formulated to discover the conceptual legal problems concerning trust law in Bangladesh, and the lack of institutional understanding of trust law and why it is needed.

1.2.1 Aims of the Empirical Research

The aims of this study were to obtain original empirical evidence from provident and pension funds management and practices. This was done so in order to provide critical information that was not available in the theoretical literature, and to prove or disprove three key research questions pursued in this thesis.

Those three questions are:

- What is the rationale for Bangladesh establishing a more universally accessible pension fund system and what is the value of establishing such a fund? (Chapters 1, 2 and 3).
- What are the legal and administrative problems for nascent institutions in Bangladesh – particularly, those for the administrators of the provident fund and insurers of the fund in Bangladesh (Chapters 3 and 4). Here the author sought to articulate the problems facing the trustee in trust law administration such as the ability to separate the fund from government administration.

- What model for the separate and independent trustee might be adopted (Chapter 5 and 6) and how should weaknesses in the regulatory framework be overcome? (Chapter 7). The author particularly wanted to find critical empirical evidence as to the legal and administrative shortcomings in administering the existing provident funds system.

The aim of the first question was to obtain empirical evidence regarding why Bangladeshi people must have access to pension and provident funds.

The second aim of the empirical study was to obtain more qualitative evidence of the accuracy of the major ADB and World Bank reports that were published some years ago, concerning the nascent stage of development in relation to trust law in Bangladesh. The author will examine the core roles of the trustee and investment manager of the Bangladeshi provident funds system.

Finally, the aim of the third question was to obtain empirical and qualitative evidence for the currently operating framework which is weakly regulated and administered, as reported by the ADB and World Bank.⁴³¹ The empirical evidence obtained, involving investment management and the power of the trustee, revealed how the establishment of the trust framework in pension and provident funds in Bangladesh, might occur.

Motivation for this research arose from a perception that Bangladeshi trust law and its effective administration are legally deficient. Substantiation for this perception was found in the WB and ADB reports, which highlighted the many failings in the practices of pension and provident funds and its investment within Bangladeshi trust law and trust administration.

1.2.2 Significance of the Empirical Research

This empirical study confirms the critical ‘sticking points’ for the development of a universally accessible pension fund, and its domestic and international investment management.

In answer to the research question of whether or not trust law can work in Bangladesh properly, or if Bangladeshi practices within a trust framework can work similarly to pension funds and investment management, Australian and Singaporean models were described. This empirical

⁴³¹ Asian Development Bank (August 1999) *TA 2915-BAN: Insurance Industry and Pension and Provident funds Reforms*.

study suggests that Bangladesh might consider that the separate and independent trustee, subject to corporate and prudential regulation, in the Australian superannuation system, may provide a secure longer term structure for a heavily populated country such as Bangladesh. Nevertheless, more directly governed funds for international investment such as CPF (or the listed investment entity Temasec) in Singapore and the more closely regulated fund in India also have valuable lessons for Bangladesh in the shorter term (see Chapters 5 and 7). Singapore may also provide a valuable first step for Bangladesh in paving the way for more effectively utilisation of savings for international investment.

1.3 Key Findings

Some of the key findings were as follows:

- I. Bangladesh was very different to a Western country such as Australia, and interviewees preferred to consider comparisons with India, where significant recent developments had occurred and Singapore provided an example of high executive control with little broader regulation.
- II. Failings of law and trust administration are generally seen to be limiting the creation of a strong pension fund market with key limitations relating to the buying and selling of contributions on or off the market in the short-term. This practice should be changed to promote long-term investment.
- III. For those citizens not able to contribute to the national savings fund, including the contributions from the target group of citizens, interviewees supported government contributions to a fund such as the Indian NPS fund within a regulatory framework. Reform of the trust law and trust administration in Bangladesh, can establish a good investment and management regime for a universally accessible national pension scheme.
- IV. Those citizens who are not currently employed in either the government or private sector, and having no pension and provident funds, should also be able to access a universally national pension fund by being allowed to contribute according to their affordability. For

those who are not employed, and cannot afford to contribute, empirical studies suggest that the government be required to contribute on their behalf a nominal amount, dependent on their status as citizens within Bangladeshi society and legislated into force. The result will be an accumulation of future savings for distribution, as required at time of retirement.

- V. Empirical research suggests that interviewees are becoming aware of the need for a dedicated Bangladeshi national fund, in the nature of a sovereign wealth fund or future fund. In providing a response to this issue, the study found that a real need exists in Bangladeshi society for this type of fund for investment. In doing so the objectives of social justice theory would be better served if the monetary benefits derived from the national savings funds were more fairly and efficiently utilised. It may also help reduce the risk of political instability.
- VI. Empirical evidence supports targeting the socio-economic groups identified by the author as able to make initial contributions. To quickly facilitate the necessary contributions to the universally accessible pension fund, higher income and middle class citizens, who have earnings that can be contributed to the fund, should do so. At the same time, the government could offer tax exemptions or tax benefits to those contributing to this type of future fund.
- VII. The author's empirical research suggests that the best model was for the trustee to be separated from and independent of the executive arm of government. The trustee entity will comprise government senior personnel, private persons, and either national or international investment experts.
- VIII. Empirical evidence shows that when government or private level employees or non-employees make contributions to the national fund, those contributions will firstly be invested by well experienced investment managers within a trust framework. In the first instance, the government will safeguard and control the security of these investments under a legislative and regulatory framework. In the short-term both the government and the independent trustee may be able to afford prudential protection of local pension funds.

- IX. In relation to the domestic stock market, interviewees expressed a clear lack of confidence and anticipated immediate profit-taking by traders at the first mention of a possible downturn, without establishing longer term and portfolio investment to create a more stable and deeper market.
- X. The empirical study suggests the need for an independent trustee and trust law reform (Chapter 6), within a secure regulatory framework (Chapter 7) so as to provide a secure fund for investment that is flexible enough to create a trust framework. People would then have faith in making contributions to a universally accessible fund, and be empowered through the new knowledge of how a successful pension and provident funds system would operate similar to Western models for global investment purposes.

1.3.1 Who was interviewed?

Interviews were conducted with 25 individuals representing different industrial or economic sectors in Bangladesh. Of these 25 interviewees, ten were from the government, five from law firms, five were academics and five interviewees were from private insurance and other corporations. All interviewees were experienced people holding senior positions. Each had years of expertise that produced answers to the critical theoretical and academic research questions posed by the author. The following table indicates the categories and origins of interviewees. At the time of investigation, only one person was available to represent the World Bank at an interview. However, that person was also a Bangladeshi national and is included in the government category.

Table 1: Categorisation of Interviewees

Type of Work	Bangladeshi Workplace	International Workplace
Government	09	1
Law firms	05	0
Universities	05	0
Fund Manager	03	0
Insurer	02	0
TOTAL	25	

Those who were interviewed held senior roles within their specific organisation, with an emphasis on pension and provident funds management and administration. Included were ministers, secretaries, compliance managers, senior economists, chief executive officers, directors, investment managers, government officers, academics and lawyers.

1.3.2 Interview Process

Potential interviewees were initially identified and approached by telephone with follow-up e-mail information about the purpose and objectives of the study. Appointments were negotiated to ensure the appropriate personnel were interviewed.

Generally, individuals were interviewed at their own work place, and these lasted approximately 45 minutes. Both interviewers were present at each interview and took notes of the interviewee's responses. Consent forms containing confidentiality guarantees were given to all interviewees prior to the event; they were then signed and returned to the interviewer at the end of the session.

1.3.3 Data Transcription

The interview questions were structured to solicit comments and views as to different aspects of pension and provident funds management practice, founded upon well understood principles of trust and corporate law. The questions elicited different views of organisational practice, and the application of legal principles and government policies in critical areas of research.

For each interview, notes were taken by the interviewer and these were subsequently transcribed into a summary. The summaries were then examined to ascertain answers for each question. This reflected the organic nature of interviews which helped the researcher achieve his goal.

Part 2: The Interview Schedule

Confidentiality Advice:

Thank you for agreeing to participate in this study. The questions invite your general opinion only and do not require disclosure of any confidential information about your organisation or your clients. We should also confirm that we will not be attributing any comments specifically to you or your organisation in the findings which we will publish on the completion of this research project. The interview will take up to forty-five minutes.

Business Structure of Government Employees' Pension and Provident Funds

Q1. The focus of this study is directed ultimately to increasing Bangladeshi national savings and investment through their contribution to a universally accessible superannuation system within an appropriate legal and regulatory framework. We are really interested in that part of the provident fund of Bangladesh you are responsible for.

Could you please tell us broadly what fund is managed by you, how your business is organised and how you invest the fund?

Q2. In particular, we refer to the ADB TA 2915-BAN 1997 Report on the Bangladeshi Pension and Insurance sector which explores trustee management, trustee administration and the separation issue involving the government sector. The report highlighted: (1) insurance and pension provident fund sectors were in a nascent stage of development; (2) a weak regulatory and operational framework; and (3) the regulator was institutionally very weak due to a severe shortage of:

(a) Qualified staff

(b) Poor leadership

(c) Deficiencies in organisation

(d) Policies and procedures; and

(e) Inadequate support from Ministry of Commerce (MOC) – now the Ministry of Finance (MOF) – and government.

Please explain to us your experience about what is the most significant failing in building a universally accessible pension and provident funds in Bangladesh.

Q3. If you manage this provident fund, could you further describe how the fund is managed and invested?

Q4. How does the government differentiate its role as an employer and its role as a trustee in investing the provident and pension funds within government's own control?

Q5. Is it possible for the Bangladesh government to undertake direct ministerial responsibility for establishing a Government Sponsored Body that could manage private or special provident funds within a regulatory scheme?

Q6. There is a contributory provident fund available to every non-pensionable government employee in Bangladesh. One possibility might be to consider extending the contributory provident fund to all citizens as a universal accessible national pension fund. Do you think it is possible for Bangladesh?

Q7. In developing countries we have seen provident and pension funds play a central role in the movement towards greater social and economic justice (e.g. adoption of progressive taxation regimes or tax concessions). I am wondering whether this system might be implemented in Bangladesh. What is your opinion?

Q8. Do you think that the provident fund is an effective way to raise more capital for investment on domestic or international markets and to improve returns for beneficiaries?

Q9. The Asian Development Bank, the World Bank, the International Monetary Fund and the International Organisation of Pension Supervisors are concerned with the Bangladeshi pension and provident fund system; do you agree with their approaches and the guidelines they have established? (e.g. the World Bank's 'multi-pillar' approach, or the IOPS's trustee system)?

Q10. India invests more than 85% of its employees' provident fund in public bonds and has established the Pension Fund and Regulatory Development Authority (PFRDA) to extend the contributory pension scheme to all citizens (18-55 years old) as an alternative. Would you think that this could apply to Bangladesh?

Q11. In Singapore both the employees and employers make compulsory contributions each month into the retirement benefit plan. Would this be appropriate for Bangladesh both in the public and private sectors?

Q12. I also wonder whether the provident fund might be used to promote private investment within a trust framework. For that purpose Bangladesh needs to amend its existing trust law. Would you prefer to add any requirement to this framework so that it functions better?

Q13. What are major impediments in the provident fund investment and how can these obstacles be overcome?

Q14. Corporate governance practices are improving in all Asian countries. Institutional investors can play a large role in promoting these improvements. Could you please tell us what is the status of corporate governance in investment of your organisation's provident fund?

Q15. The larger industrial groups including agriculture and garment workers are fully excluded from pension and provident fund facilities. They have a legal and constitutional right to such facilities. Could you tell us how the social protection/safety net could be extended to them?

Legal Structure of Pension and Provident Funds (addressed to lawyers)

Q16. The provident fund might also serve as a social security program as provided under the *Provident Fund Act 1925* of Bangladesh. Could you tell us how this Act, which has been set up only for government employees, acts as a safeguard for all citizens?

Q17. Do you think that Bangladesh does need dedicated social legislation and corporate regulations to establish the old age pension or provident funds for all citizens?

Q18. Does it do any good to extend a contributory provident fund to all citizens within a regulatory framework?

Q19. There are many professionally registered persons in Bangladesh who earn handsome amounts of money. We are really concerned with those people who might be targeted for extending the Bangladeshi Provident Fund into a universally accessible national pension fund. Would you be prompted to support the government to make a law and regulations for such a regulatory scheme?

Q20. How important are trust law and trust administration, investment management law, freedom of information law and criminal law in Bangladesh for establishing a trust fund specifically for pension funds for investment within a trust regime?

Q21. How will Bangladesh adopt sound governance norms that emphasise accountability and transparency in trust and corporate practice?

Q22. How much law reform will Bangladesh require to put in place a trustee system in pension funds investment?

Q23. Does Bangladesh need a separate regulator for implementing international corporate principles in order to invest in the financial markets?

Q24. India has been developing its pension market domestically by supporting the role of insurance companies in providing pension products, including annuities and mutual funds since 2001. Could you tell us what are the sticking points in law in Bangladesh for developing mutual or trust funds for the financial markets?

Q25. Bangladeshi civil servants are covered under a non-contributory, pay-as-you-go pension systems administered by the government's General Pension Fund (GPF). This contribution is deposited with the government in the Bangladesh Public Account. These funds are not segregated as trust funds and invested. The rate of return is fixed and not market-comparable. Could you tell us how this system meets the role of trustee?

Q26. A corporate trustee or independent expert can offer a good business strategy and secure the beneficiaries' interest in investments. What legal issues arise if an independent trustee offers to look after the pension funds for investment?

Pension and Provident Funds of Private Organisations including the Insurance Industry

Q27. In the global financial markets issues involving the legal foundations and administration of pension funds are becoming very important. Could you tell us how much pension reform or privatisation does Bangladesh need to establish a strong national savings net?

Q28. Does your organisation make any distinction within the government pension system between compliance on one hand, and analysis/investment on the other?

Q29. You are aware that the lack of experience for long-term investment provision is a sticking problem for the insurance industry in Bangladesh. Can you suggest how this problem can be resolved so that investment management is more valuable to pension fund trustees?

Q30. In the management of different types of funds by your organisation (e.g. pension, provident, insurance and gratuity), is the same system generally followed in providing benefits to your employees as occurs with government employees?

Q31. If your organisation invests employees' or public funds, could you tell us how you secure their best interests?

Q32. What safeguards do you provide to maintain the pension funds for investment?

Q33. Do you think that the decentralisation of provident funds increases private sector investment in the market with competitive pension products? Is it good for beneficiaries?

Q34. Do you expect that tax incentives and a regulatory framework will help the development of a sovereign wealth fund or national savings through a more accessible pension fund system for investment?

Q35. What features should a Bangladeshi trustee have in order to corporatise pension and provident funds domestically and internationally?

2.1 Description of Interview Schedule

A structured interview schedule comprising 35 questions was developed. A copy of this interview schedule is found in Appendix A. The questions in the interview schedule identify three main parts of inquiry in the study. These were: firstly, the business structure of the government employees' pension and provident funds; secondly, the legal structure of the pension and provident funds; and thirdly, the pension and provident funds of private organisations including the insurance industry. Interviewees' responses to the questions in each of these areas are recorded and analysed in detail in three parts (Parts 3-5).

At the beginning of each part, there is a summary of the key points from interviewees' responses to that group of questions. Each part contains the table indicating the interviewees who participated in that group of questions. A summary of the major findings is set out in each part. These summarised results are referred to in other thesis chapters.

Part 3 (Interview Schedule QQ 1-15):

Business Structure of the Government Employees' Pension and Provident Funds

In this section, questions were asked regarding the interviewee's business, organisation of business, and the investment of pension and provident funds. Questions about a universally accessible national pension fund, trustee management and administration within or outside government were also asked. Questions about the operation of an insurance and provident fund framework were also asked. Interviewees were also asked specific questions regarding the criticisms made by the ADB and whether they agreed with these criticisms. They were also asked to express their views on the multi-pillar approach for a pension fund as suggested by the WB, and comparing the pension funds system of India and Singapore. Finally, they provided opinions on the corporate governance practices in Bangladesh's pension and provident funds system.

Table 2: Categorisation of Interviewees in the Government Sector

Ministers and Members of Parliament	3
Secretaries	6
Senior Economist of the World Bank	1
TOTAL	10

The Major Findings: The interviewees in this group responded generally in a similar way to the questions of this section. Briefly they mentioned that Bangladesh needs this type of social safety network because it can provide a national security to the people in their old age. They emphasised the importance of making new policies, strong regulations and a monitoring system. Most of them agreed with the ADB's report concerning the failings of the Bangladeshi provident fund and insurance industry. They agreed that Bangladesh requires a separate and independent regulatory and monitoring body for provident fund administration, management and investment in consultation with the government. Interviewees believed that this universal accessible national pension and provident fund would represent a very significant step in securing social welfare and human rights in Bangladesh.

Most said that this step would enable social justice to become part of national policy. They also mentioned that although this may initially be a hard task, it would be possible to create a fully-implemented universal provident fund in about 20-25 years. One of the interviewees in this group said that the poor people of Bangladesh had adopted Dr. Yunus' micro-credit system in the past and, as a result of this experience, they would accept the idea of a universally accessible national pension and provident fund system. However, they would need more education and political support on how this system would be implemented.

Part 4 (Interview Schedule QQ 16-26):

Legal Structure of Pension and Provident Funds (addressed to lawyers)

In this section, questions were asked regarding each interviewee's response how existing provident fund law is structured in Bangladesh, constitutional guarantee for a social safety net, contributory provident fund and the possibility of creating a universally accessible national provident fund system within a regulatory and corporate trustee framework. Questions about funds investment, funds management, and mutual funds within a sophisticated corporate framework were also asked.

Table 3: Categorisation of Interviewees in the Legal Sector

Senior Lawyers (Legal Practitioners of the Supreme Court of Bangladesh)	5
Academics (Professors of Law, Legal Consultants)	5
TOTAL	10

The Major Findings: This group of interviewees noted firstly that Bangladesh does not have uniform pension legislation which ensures a social safety net for all citizens. Bangladesh only secures the pension and provident funds for government employees. They said that there are no appropriate regulations undertaken by the government or the private sector for ensuring the pension and provident funds system to employees. The government does not publish gazettes or notifications on how this industry works. The government controls this fund and interviewees said that there is no separate regulator and trustee framework. Even the government does not know how much money has been accumulated in these funds. The government can use this general provident fund any time without obtaining prior consent from employees, for example in overcoming a budget shortfall. Interviewees said that there is no fund manager who operates this fund because in a true sense this fund is still unfunded. Contributors have a fixed rate of interest when they contribute to the provident fund.

Interviewees acknowledged that this provident fund belongs to employees, but while there is no right to use this fund without their consent, the government does so as a presumed trustee. This group said that they do not have any pension fund. Instead they contribute to provident or benevolent funds which operate without any trustee or corporate framework. They remarked that they are receiving a fixed rate of interest and they do not know where this fund has been invested. This group also mentioned that the government should undertake responsibility for building a national pension and provident fund network so that national savings could be marshaled for investment.

Interviewees added that to do so Bangladesh needs a sound legal and regulatory framework with a strong monitoring system. Criminal punishment may be considered if national provident and pension fund laws and regulations are breached. These interviewees said that subsidies might be considered for the poor people. They emphasised the need to adopt international corporate principles and norms to build this safety net for Bangladesh through national pension and provident funds.

One interviewee responded differently. He said that it is not possible for Bangladesh to develop this type of fund because most of the people live below the poverty level, and they will not be able to generate enough savings into the national pension and provident funds. The poor people will not be part of this scheme at all. He also mentioned that this fund must be employed on the domestic market, not the international market.

Part 5 (Interview Schedule QQ 27-35):

Pension and Provident Funds of Private Organisations including the Insurance Industry

In this section, questions were asked regarding the autonomous power and discretion enjoyed by interviewees in responding to the privatisation or reform of the pension system, compliance, lack of awareness for long-term investment such as life insurance, management and investment of public funds in a private organisation, and trustee features in Bangladesh.

Table 4: Categorisation of Interviewees in the Private Sector

Fund Managers	3
Insurers	2
TOTAL	5

The Major Findings: This group of interviewees stated that the insurance system in Bangladesh is narrowly focused. People do not really understand long-term investment through insurance schemes. They mentioned that insurance and provident funds in the corporate framework do not exist in Bangladesh. The interviewees also added that the trustee and transparency systems are very important if people are going to be interested in being a part of this industry.

They said that Bangladesh needs private sector pension fund companies who must be professional and competitive in offering investment returns. Institutional investors and fund managers must be attentive to deal this fund within a regulatory framework. They added that a clear separation of roles and accountability at every stage of investment management needs to be secured for a nationally accessible provident fund in Bangladesh. Interviewees said that in Bangladesh most insurance companies do not handle pension and provident fund schemes. Even their own employees do not have provident funds provided by the companies. The interviewees emphasised the need for an independent trustee system within a sophisticated legal framework so that national savings could be marshaled for a provident fund.

Interviewees mentioned that this type of fund must merge everyone's contribution based on their income and capability. Investment returns would then be distributed in accordance with their share. Interviewees noted that Bangladesh needs to reform its legal structure, corporate sector and monitoring system if a contribution program based on compulsory savings is to be established. They emphasised that contributors should be divided into different groups according to their level of income. They also said that those managing the fund must be reliable and above reproach. This controlling agency must be a statutory institution that is separate from the government and free from political interference.

APPENDIX B

WHO MIGHT CONTRIBUTE TO THE PENSION SCHEME?

In accordance with the provision of Articles 80 and 81 in Part V, Chapter II of the Constitution of the People's Republic of Bangladesh,⁴³² the government is empowered to use the legislative and financial procedures for national budget and taxation.⁴³³ In this way the government may consider tax concessions for targeted socio-economic groups that have the means to contribute to national savings through a universally accessible pension fund (see Chapter 3).

A fundamental question in establishing a universal pension fund for Bangladeshi citizens would be whether such a substantial base of potential contributors exists. As Bangladesh is a poor country, a 'target' group may need to be ascertained as to whether the fund can be established at all (see Chapter 4). The target group could comprise: firstly, the middle and high income earner groups, made up of individuals and companies who are taxpayers; and secondly, those who have sufficient assets.

Under the provision of tax⁴³⁴ and wealth assessment⁴³⁵ in Bangladesh, the people mentioned below are required to pay tax. Otherwise, if they have sufficient assets for living they might be also considered suitable contributors to the national savings scheme through a universal pension fund:

- Males whose yearly income exceeds BDT 1, 65,000/-.
- Females whose yearly income exceeds BDT 1, 80,000/.
- Senior taxpayers who are 65 years and above and retired taxpayers whose yearly income exceeds 2, 00,000/.
- People who have been assessed as income taxpayers for 3 consecutive years.
- A person who lives in any city corporation/paurashava/divisional HQ/district HQ and owns a building of more than one storey and having a plinth area exceeding 1,600 sq.

⁴³² Articles 80 and 81 of the Constitution of the People's Republic of Bangladesh comment on the legislative power of money bill.

⁴³³ Articles 83 and 87 of the Constitution of the People's Republics of Bangladesh. They state respectively: "there shall be laid before Parliament, in respect of each financial year, a statement of estimated receipts and expenditure of the government for that year, in this part, referred to as the Annual Financial Statement" (i.e. the Budget); and "no tax shall be levied or collected, except by or under the authority of an Act of Parliament".

⁴³⁴ Bangladesh *Income Tax Ordinance XXXVI* of 1984.

⁴³⁵ Bangladesh *Wealth Tax Act*, 1963 (Act No. XV).

feet/owns motor car/owns membership of a club registered under the VAT law of Bangladesh.

- A person who owns a telephone.
- A person who runs a business or profession and has a trade license in his or her own name.
- A person who is professionally registered as a doctor, lawyer, and income tax practitioner, chartered accountant, cost and management accountant, engineer, architect and surveyor, etc.
- Member of a Chamber of Commerce and Industries or a trade association.
- Any person who participates in a tender.
- A person who has a Taxpayer's Identification Number (TIN).
- Candidate for Union Parishad, Paurashava, City Corporation or Parliament.
- A person who owns a company, factory or any industry.

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