Dip into EPF corpus only as a last resort

Withdrawing to fund consumption could dent old-age financial security

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The financial hardship unleashed by the Covid-19 crisis — job losses, severe salary cuts, high medical expenses, etc — have led many subscribers of the Employees' Provident Fund Organisation (EPFO) to withdraw money from their accounts. According to media reports, 80 lakh subscribers of the EPFO have withdrawn ₹30,000 crore between April and the third week of July — an amount higher than the outgo usually seen over similar periods.

On March 28, the Labour Ministry had issued a notification that allowed people to withdraw money from their EPF account to deal with the Covid crisis. Given EPF's significance as a retirement-saving tool, the decision to withdraw money should be a properly deliberated one.

EPF RATE HAS BEEN DECLINING

Financial year	EPF rate (%)
2015-16	8.80
2016-17	8.65
2017-18	8.55
2018-19	8.65
2019-20	8.50

But it is still relatively high

Instrument	Interest rate (%)
Sukanya Samriddhi Account	7.6
Senior Citizens Savings Scheme	7.4
Public Provident Fund	7.1
Kisan Vikas Patra	6.9
National Savings Certificate	6.8

Sources: Groww.in, Indiapost.gov.in

An invaluable retirement tool

EPF's primary purpose is to help employees build a retirement corpus. "Due to increasing longevity, people nowadays have a long post-retirement life to take care of. The EPF money should hence be treated as sacrosanct and not touched except in dire circumstances," says Anil Chopra, group director-financial wellbeing, Bajaj Capital.

Several factors make EPF an invaluable retirement-saving tool. One, it offers a higher rate of return — 8.5 per cent in 2019-20 — than any other government instrument. The implicit government guarantee means employees do not need to worry about credit risk. Moreover, since the money is deducted before the salary is paid out, the corpus accumulates silently and steadily over time. "From a behavioural angle, EPF is a great instrument because it inculcates the discipline of regular, automatic, monthly saving," says Ankur Maheshwari, chief executive officer, Equirus Wealth Management.

EPF also enjoys a favourable exempt-exempt-exempt) tax treatment — it is not taxed at entry, while the money is invested, or at withdrawal. Finally, there is the benefit of compounding. Those who leave the money untouched for decades retire with a hefty corpus.

Avoid taking a loan

Those who are facing hardships currently should avoid taking a loan. "You do not know when you will find another job, or when your salary will get restored. Do not add an expensive loan to your other financial burdens. Instead, liquidate your investments," says Maheshwari.

Withdraw only if in dire need

Money should be withdrawn from EPF only as a last resort. "If you don't have any other source of income, have exhausted your other investments and are still having difficulty meeting your essential expenses, or if you have a medical emergency, then you may dip into your EPF corpus," says Chopra.

You may also do so if your credit history is going to get affected. "Once the moratorium ends, your credit history could get affected if you don't pay your EMIs or pay them late. This will affect your ability to access loans in the future. In that case, use your EPF money," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors.

Strategy for liquidation

Equity has the potential to offer higher returns over the longer term while fixed-income instruments offer lower but certain returns. Experts vary in their opinion on how you should liquidate your portfolio. "Sell both equities and fixed-income instruments in a proportion that your asset allocation remains unchanged," says Maheshwari. For those who find this approach complicated, Raghaw suggests selling equities and debt in a manner that you get 50 per cent of the amount needed from each. Since the markets have largely recovered, you will not sustain a major loss if you sell your equity-based holdings currently. Dhawan suggests selling off debt investments and leaving equity-based instruments untouched because the latter are meant to achieve longer-term goals. But this could leave your portfolio equity-heavy and should only be adopted by those who have the necessary risk appetite. Next, move to the product level. On the fixed-income side, list all your investments in increasing order of post-tax return. Sell those that offer lower returns first.

In case of instruments that offer variable returns, like debt funds, stocks, etc., carry out the same exercise but based on potential return. "Suppose that a gilt fund has given 8 per cent return in the past year and a fixed deposit (FD) is giving 6 per cent currently. It does not mean you should liquidate the FD first. Now that interest rates have come down, it may make more sense to dispose of the gilt fund first," says Dhawan. Also, consider costs like taxation and exit load while deciding the order in which to sell. Lastly, use this as an opportunity to dispose of sub-par, poorly selected instruments.

Youngsters beware

Many younger employees have used the eased-up norms to withdraw money hastily from their EPF accounts. One reason is they believe they can earn higher returns from equities. Says Dhawan: "Even younger investors need to have some allocation to fixed-income in their retirement portfolios. Equity markets can remain depressed for prolonged periods, so you need debt to provide stability." EPF is well suited to constitute the debt portion of the retirement portfolio.

Many younger employees have also dipped into their EPF corpus because their consumption need overrides their savings need. They should try to curb their consumption expenses instead. Withdrawal from EPF now can exact a heavy toll on old-age security.

Finally, avoid withdrawing from EPF as far as possible because it is difficult to replenish. "Your contribution to EPF and Voluntary Provident Fund cannot exceed 100 per cent of your basic salary," informs Raghaw.