

**LAW ON FUNDED PART OF THE LABOUR PENSIONS (DRAFT)**

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## DEFINITIONS

**Executive Authority** – public authority which is delegated to perform activities prescribed in the law and providing administrating function and asset management function for the funded part of the labour pensions.

**Pension Fund** – State Pension Fund or Private Pension Funds providing asset management function.

**Pension plan** - a set of rules that provides the existing and potential participants of funded part with sufficient information on their participation, including information regarding fees and charges for the pension plan administration and management, investment policy and investment limits, risks, the rights of the pension plan participant, the pension plan asset management, methods and procedure for the pension plan assets valuation and net assets value calculation, information about taxes and fees, other information necessary for the existing and potential participants of the funded part.

**State Pension Fund** – respective administrative body or department according to organisation structure of the Executive Authority to provide asset management function for the funded part of the labour pensions and organisationally separated from other functions performed by the Executive Authority.

**Private Pension Funds** – legal entity established in accordance with the law on Private Pension Funds and providing asset management function for the funded part of the labour pensions.

**Administration function** – activities related to administration whole system of the funded part of the labour pensions and maintenance of the personal accounts of the participants of the funded part including record-keeping of the funded part pension capital accrued. Respective function includes also signing and executing contracts with entities providing asset management function.

**Asset management function** – activities related to management of the assets of the funded part including implementation of the investment strategy in compliance with conditions of the pension plan.

**Open investment fund** - a collective investment undertaking aimed at investing money assets aggregated from the public in the investment objects (as defined in the Law) in line with the principle of diversification and investment restrictions where the company managing such fund shall have an obligation, upon request of fund investors, to repurchase investment certificates not later than within one month. Open investment fund shall be registered in the Republic of Azerbaijan or OECD member state.

**Investment object** — transferable securities (as defined in the Law), money market instruments, deposits in banks and other financial instruments, which in accordance with the provisions of this Law an investment management company is entitled to acquire for the fund property;

**Transferable securities** — equity securities (shares and other equity securities which certify participation in the issuer's capital), bonds and other debt securities, other negotiable

securities whose alienation rights are not restricted and to which the rights to acquire the above mentioned transferable securities by means of subscription or exchange are attached;

**Alternative investment fund** - a collective investment undertaking which raises capital from a number of investors with a view to investing it in accordance with an investment policy for the benefit of those investors. Alternative investment fund is not open investment fund in the meaning of the Law. Alternative investment fund shall be registered in the Republic of Azerbaijan or OECD member state.

**Funded part pension capital** – capital accrued in the individual account of the participant of the pension plan considering all contributions paid in, investment yield (return) and costs and charges deducted.

## CHAPTER I. GENERAL RULES

### Article 1. Purpose of Law

This law prescribes the general principles for the establishment and operation of the funded part of the labour pensions (hereinafter – funded part), the general provisions for the contribution, administration, management, investment and pay-out of the funded part pension capital, as well as state supervision of such activities.

### Article 2. Funded Part of the Labour Pensions

- (1) Funded part is a component of the labour pension consisting of accrued funded capital in accordance with the Law of the Republic of Azerbaijan on Labour Pensions.
- (2) The purpose of funded part is to provide additional income for use in old age, accumulating retirement savings by investing contributions in financial markets.
- (3) Funded part is a state organised set of measures for making contributions, administration and investment of assets and pay-out of funded part pension capital.

### Article 3. Role of the Executive Authority

The Executive Authority shall be entitled to provide both administrative function and asset management function in accordance with the legal requirements set by this law.

## CHAPTER II. PARTICIPATION TO FUNDED PART

### Article 4. Scope of Participation

- (1) All persons who are subject to the State insurance in accordance with the Law of the Republic of Azerbaijan “On Social Insurance” and who were born after */date, month/year<sup>1</sup>/* for men and after */date, month/year<sup>2</sup>/* for women may participate on a voluntary basis to funded part.

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<sup>1</sup> Depends on the Law comes into force. Apply for persons who have not reached 15 years before age limit indicated in Article 7 of Law of the Republic of Azerbaijan on Labour Pensions

<sup>2</sup> Depends on the Law comes into force. . Apply for persons who have not reached 15 years before age limit indicated in Article 7 of Law of the Republic of Azerbaijan on Labour Pensions

- (2) Participation in funded part will not expire before the time the participant has reached the general retirement age for the mandatory old-age labour pension in accordance with Article 7 of the Law of the Republic of Azerbaijan on Labour Pensions upon request of the participant and in case of death of the participant. For other reasons, participation cannot be withdrawn or terminated.

#### **Article 5. Registration of Participants**

- (1) The registration of the participants shall be carried out by the Executive Authority, that is in charge of the management of the mandatory state social insurance (hereafter – the Executive Authority).
- (2) Person specified in Article 4 shall submit the application for participation in the funded part to the Executive Authority. Simultaneously person shall select the Pension Fund and the pension plan.
- (3) The person shall be registered as a participant of funded part from the first date of the second month that follows the month when the application regarding inception of participation in the funded part has been received.
- (4) Not later than within 10 working days from the registration day the Executive Authority shall notify to these persons a notification regarding registration for participation in funded part.
- (5) Not later than within 10 working days from the registration day in case of employment the Executive Authority shall notify the participant's employer as well and additionally provide him with specific payment instructions with regard to the Rules of Social Contributions and the Rules for registration of insurance participants for mandatory state social insurance.
- (6) Each participant of funded part has the right to choose between the State Pension Fund and the Private Pension Funds (if established).
- (7) The Executive Authority shall ensure, in accordance with the rules established by the Executive Authority, that participants are provided with relevant pre-enrolment information including information on all pension plans available for choice, to make a decision on participation in particular pension plan.
- (8) Participant has the right, in accordance with the rules established by the Executive Authority, to change the Pension Fund of his or her funded pension capital accrued or the pension plan if the Pension Fund has two or more pension plans. It is permitted to change the Pension Fund not more frequently than once a year, but a pension plan of one and the same the Pension Fund – not more frequently than twice a year, as well as additionally when:
  - 1) reorganisation of the Pension Fund selected by the participant of funded part has occurred;
  - 2) The Pension Fund merges pension plan selected by the participant of funded part with another pension plan (plans) and has registered with the Financial Supervisory Authority (hereinafter – the Supervisory Authority) a new pension plan (new version of the pension plan) or add the selected the pension plan to another pension plan managed by the same the Pension Fund.

### **Article 6. Contributions to Funded Part**

- (1) The contribution rate to the funded part is 4 % of the participant's earned wages and incomes in accordance with Art.15 et seqq of the Law of the Republic of Azerbaijan "On social insurance" and Chapter IV of the Rules for collection of mandatory state social insurance contributions.
- (2) In case of employment the contributions shall be paid by the participant's employer combined and at the same time with the contributions to the mandatory state social insurance according to Article 14 et seqq of the Law of the Republic of Azerbaijan "On social insurance" and Rules for collection of mandatory state social insurance contributions.
- (3) Participants are entitled to suspend contribution payments for an unlimited period of time at any time. Suspension of the payment of contributions is not permitted within the first 3 years of starting contributions payment.
- (4) Participants who wish to suspend contribution payments according to (3) shall give notice to the Executive Authority and to his/her employer in case of employment at least one month in advance of the desired suspension of the payment. If they wish to resume contribution of the payment after the suspension, participants shall:
  - a. give notice to the Executive Authority and to his/her employer in case of employment at least one month in advance of the desired resumption;
  - b. after resuming contribution, participation is re-established in the pension plan from which it was last suspended.
- (5) In case of self-employment or other jobs on the grounds of contractor, task, commission, author and other civil contracts, not subject to the Labour Code of the Republic of Azerbaijan (thereafter – self-insured persons), the contributions have to be paid in accordance with Article 14 of the law of the Republic of Azerbaijan "On social insurance" with the exception, that a contribution rate as stipulated in clause (1) will apply. The contributions shall be paid by the participants themselves.
- (6) Concerning the registration and reporting of contribution payments, Chapter VII of the Rules for collection of mandatory state social insurance contributions will apply.
- (7) For delayed or non-payment or other violations of rules on contributions, Art. 18, 21 of the law of the Republic of Azerbaijan "On social insurance" and Chapter VIII of the Rules for collection of mandatory state social insurance contributions will apply as well as Chapters IX and X concerning control over payment and complaints of insurers.
- (8) In case the employer pays the contributions, the employer will be held fully liable for the lawful payment of the contributions according to the Law of the Republic of Azerbaijan "On social insurance" and the Rules for collection of mandatory state social insurance contributions, regardless whether the employee is entitled to such payments by labour contract in accordance with the Labour Code of the Republic of Azerbaijan or the payments are carried out on employee's direction.

## **CHAPTER III. OVERSIGHT, ADMINISTRATION OF OPERATION AND PROCEDURE FOR ACCOUNTING OF THE PARTICIPANT ACCOUNT AND CALCULATION OF FUNDED PART CAPITAL**

### **Article 7. Oversight of Operation of Funded Part**

- (1) The Supreme Authority shall perform the oversight of funded part.

(2) In accordance with this Law, the Executive Authority each year prepares a report regarding the operation of the funded part which provides a true and clear representation regarding the management of funded part, contributions made and transfers, the report of the operation of funded part and submit to the Supreme Authority. An independent auditor, in accordance with the law on audit services of the Republic of Azerbaijan (hereafter - independent auditor), approved by the Executive Authority shall audit the report in accordance with international auditing standards.

#### **Article 8. Role of the Executive Authority in Providing Administration Function**

- (1) In accordance with this Law the Executive Authority shall:
- a. register contributions made to funded part and accrue funded pension capital;
  - b. inform the person regarding the registration to a funded part and other significant changes in the operation of the funded part;
  - c. conclude contracts with the Private Pension Funds regarding the management of the funded part and conditions thereof;
  - d. issue a regulation for the State Pension Fund regarding the management of the funded part and conditions and providing the same conditions as in the contracts with the Private Pension Funds. The Executive Authority shall follow requirements of Article 20 of this law. The Executive Authority shall also develop procedure to eliminate potential conflicts of interest and separate functions of administration and asset management. The regulation is treated as a contract in the sense of Paragraph 1 Clause c of this Article;
  - e. ensure fulfilment of submissions of participants of funded part regarding selection and change of the Pension Funds and the pension plans;
  - f. ensure the publication of information regarding funded part and the results of the operations thereof.
- (2) In order for participants of funded part to be able to implement their rights prescribed by the law to freely select and change the Pension Funds and the pension plans, it shall be the Executive Authority obligation for the interests of participants to facilitate fair competition of the Pension Funds, ensuring the same (equal) attitude and requirements by the Executive Authority towards all the pension funds. The Executive Authority shall ensure that it is possible for any participant to get acquainted with the pension plans, statements on the last quarter results of all the pension plans of the Pension Fund as well as a report regarding the operation of the funded part upon request.
- (3) The expenses of the Executive Authority for the administration of funded part shall be covered by the deductions the Executive Authority withholds from the contributions of the participants of funded part. The maximum level of deductions shall not exceed X per cent. Exact level of deductions is set by the Executive Authority on annual basis at least by October 1 each year.

#### **Article 9. Account of a Participant of Funded Part**

The Executive Authority additional to information determined by Law of Republic of Azerbaijan On Personal Accounting in the State Social Insurance System shall ensure registration of the following information about each participant in the personal account:



- a. information about participation in funded part (date the participation was started, the name of the selected the Pension Fund and the pension plan, date when payment of contributions was suspended and restored, date when the participation was terminated);
- b. information on contributions made (the sum from which contributions were calculated, contributions made in funded part and the date they are registered in the account of a participant);
- c. information on the administration fees of the Executive Authority (scheme administration expenses of the Executive Authority attributed to a participant, type of expenses, their rate and date the above mentioned expenses are withheld);
- d. information on the transfer of contributions to the Pension Fund (the date when contributions were transferred to a Custodian of the Pension Fund);
- e. information on accumulated funded pension capital at the end of each quarter.

#### **Article 10. Registration of Contributions to the Personal Account**

- (1) Contributions to the funded part shall be registered on the personal account on the basis of information:
  - a. submitted by insurer (employer) on all its employees for whom mandatory state social insurance contributions are paid according with Law of Republic of Azerbaijan On Personal Accounting in the State Social Insurance System and taking into account information on the contributions made;
  - b. submitted by self-insured person about his/hers mandatory state social insurance contributions paid according with Law of Republic of Azerbaijan On Personal Accounting in the State Social Insurance System and taking into account information on the contributions made.
- (2) Contributions to the personal account shall be registered not later than the first working day of month following the reporting period, if the information regarding the contributions of the reporting period at the Executive Authority is completed and corrected.
- (3) If complete and correct information regarding the contributions of the reporting period is received at the Executive Authority later than making the registration of the contributions of the reporting period to the personal accounts, the contributions of the reporting period shall be registered to the personal accounts within five working days.

#### **Article 11. Transferring Contributions to Respective the Pension Plan Account with Custodian**

- (1) After registering the contributions in the personal account and according to the choice of participants regarding the Pension Fund and the pension plan, the Executive Authority not later than within 10 working days shall transfer the contributions to the respective the pension plan account with Custodian.
- (2) If in the cases prescribed in current legislation of Republic of Azerbaijan:
  - a. the participant's wage/income (mentioned Article 6 Paragraph (1)) has been reduced, contributions calculated from which the Executive Authority has transferred for management to the Pension Fund, the Executive Authority within five working days after receiving the respective information shall give

- an order to the Pension Fund regarding transfer of money to the Executive Authority budget and correct information to personal account;
- b. the participant's wage/income (mentioned Article 6 Paragraph (1)) has been increased, the contributions calculated from which the Executive Authority has transferred for management to the Pension Fund, the Executive Authority shall transfer the respective contributions to the Pension Fund in accordance with Paragraph (1) of this Article.

## **CHAPTER IV. PAY OUT OF PENSION BENEFITS**

### **Article 12. Payment of Capital of Funded Part**

- (1) Upon reaching retirement age as stated in Article 7 of the Law of the Republic of Azerbaijan on Labour Pensions and upon request of the participant to the Executive Authority, the accrued capital of funded part:
  - a) will be added to the mandatory labour pension, which will be then calculated in accordance with either Article 10 (old-age labour pension) or Article 13 (disability labour pension) of the Law of the Republic of Azerbaijan on Labour Pensions;
  - b) if accrued capital of funded part is less than XX per cent of the insurance part of person labour pension, it shall be paid as a lump sum by the Pension Fund upon receiving order from the Executive Authority.
- (2) Each participant, upon retirement shall receive relevant information regarding decumulation option applied to participant's pension capital.

### **Article 13. Inheritance of Accrued Capital of Funded Part**

If a participant of funded part has died before reaching retirement age, the whole capital of funded part registered by the day of the death of the participant will be subject to inheritance according to section 10 of the Civil Code of the Republic of Azerbaijan.

## **CHAPTER V. PENSION FUNDS**

### **Article 14. General Provisions**

- (1) Contributions to the Funded Part of the Labour Pension, as well as the earnings and other assets will be managed by the Pension Fund. The Pension Fund shall accumulate and invest the contributions to the funded part in accordance with this Law and the pension plans in order to ensure pension benefits of the participants.
- (2) Activities of the Pension Fund under this legislation will either be carried out by:
  - a. The Executive Authority acting as the State Pension Fund when providing asset management function and/or;
  - b. The Private Pension Fund established in accordance with the Law on Private Pension Funds - starting 20xx.
- (3) For the Private Pension Funds acting under this law according to Paragraph (2) b of this Article, the Law on Private Pension Funds concerning establishment and general activities of the Private Pension Funds shall apply as far as it does not contradict the requirements of this law.

### **Article 15. Role of the Executive Authority in Providing Assets Management Function**

- (1) The asset management function of funded part assets shall be provided by the Executive Authority in accordance with Article 14 Paragraph (2)a when acting as the State Pension Fund. The State Pension Fund may perform asset management activities itself or entrust it to the third party competent in asset management and having capacity to provide asset management of the funded part.
- (2) The Executive Authority shall perform transactions with funded part assets through intermediation of the custodian, entering into a custodian agreement therewith. The selection of a custodian, the duties and liabilities thereof, as well as the procedures for the entering into and fulfilment of a custodian agreement shall be determined by this Law.
- (3) In order to provide asset management function itself the Executive Authority shall comply with the following criteria:
  - a. the organisational structure of the Executive Authority shall ensure establishment of the separate independent department responsible for asset management;
  - b. employees of respective department shall be fit and proper to provide asset management of funded part;
  - c. organisational structure shall provide independence of the asset management function and administration function provided by the Executive Authority to ensure elimination of conflict of interest and introduction of the appropriate risk mitigation mechanisms;
  - d. the Executive Authority shall have in place all the necessary resources (human, financial, technological) to ensure proper functioning of the asset management;
  - e. the Executive Authority shall establish appropriate internal control system to ensure elimination of conflict of interest between administration function and asset management function and introduction of the appropriate risk mitigation mechanisms.
- (4) To be fit and proper for asset management the persons responsible should comply with following criteria:
  - a. their professional qualifications, knowledge and experience are adequate to enable them to ensure a sound and prudent management of the asset management and to properly carry out their functions;
  - b. they are of good repute and integrity.
- (5) The asset management function shall be provided only after authorisation granted to the Executive Authority by the Supervisory Authority.
- (6) To receive authorisation by the Supervisory Authority the Executive Authority shall hand in:
  - a. description of the organisational structure;
  - b. description of the internal control system;
  - c. information on person (persons) responsible for asset management of the funded part in Accordance with this law;
  - d. the pension plan developed in accordance with this law;
  - e. agreement with the custodian in accordance with this law.
- (7) The Executive Authority shall develop the pension plan providing conservative investment strategy (hereinafter – state conservative the pension plan) which complies with the requirements of Article 19 of this law. The Executive Authority may develop in addition pension plans which comply with the requirements of Article 18 of this law.

- (8) To grant authorisation the Supervisory Authority shall check:
  - a. fitness and properness of the persons responsible for the asset management in accordance with requirements of the this law;
  - b. appropriateness of the organisational structure and internal control system in accordance with requirements of the this law;
  - c. compliance of the pension plan rules and design as well as custodian agreement with the legal framework in accordance with requirements of the this law.
- (9) The Supervisory Authority shall develop procedure for authorisation process of the Executive Authority.
- (10) If the Executive Authority is entrusting asset management function to the third party (hereinafter – external asset manager) then instead of information stated in Paragraph (6) c of this Article the Executive Authority shall provide to the Supervisory Authority the contract between the State Pension Fund and external asset manager in compliance with requirements of Article 25 of this law. The asset management agreement comes into force only after approval by the Supervisory Authority.
- (11) The Supervisory Authority shall check information provided and if appropriate grant authorisation to the Executive Authority to act as the State Pension Fund as well as register the pension plan.
- (12) After authorisation the State Pension Fund shall provide quarterly reports on the pension plan according to the requirements of this law.

#### **Article 16. The Pension Plan**

- (1) Any contribution, accumulation, investment of assets means or paying-out of accumulated funded pension capital may take place only in conformity with the pension plan designed by the State Pension Fund or the Private Pension Fund and registered by the Supervisory Authority.
- (2) The pension plan shall be an integral part of the Contract between the Executive Authority and the Pension Fund. The pension plans provided to the participants of the funded part shall contain the following terms:
  - a. the type, name and legal address of the Pension Fund;
  - b. the title of the pension plan;
  - c. information regarding the asset manager, if asset management is outsourced, and the custodian bank;
  - d. the criteria and conditions relating to the participants withdrawing from the pension plan or suspension of contribution payments;
  - e. the procedures for contribution of funds and consequences in cases of violation of such procedures;
  - f. the provisions for the calculation and record-keeping of individual accounts of the pension plan participants, contributions made and pension benefits capital accumulated;
  - g. the retirement age at which the participant shall be entitled to receive accumulated funded part pension capital in the pension plan according to Article 12;
  - h. pay-out regulations in case of death according to Article 13;
  - i. the procedures for covering the expenses of the pension plan and provision of information regarding maximum payments to the management of the pension plan and to the external asset manager, if outsourced, and the amount of

- remuneration to be paid out to the custodian, as well as the procedures by which the pension plan participants shall be informed regarding such pay-outs of the pension plan;
- j. the procedure how the contributions from the Executive Authority will be transferred to the account of the pension plan with custodian and the process of reconciliation between the Pension Fund and the Executive Authority;
  - k. the procedure how the accumulated funded part pension capital are paid out according to the requirements of the Article 12;
  - l. the principles for investment of the pension plan assets, investment rules and a description of risks and the methods for determination of risks related to investments, a description of the risk management system;
  - m. other information necessary to the pension plan.

### **Article 17. Registration of the Pension Plan by the Supervisory Authority**

- (1) The pension plan shall be registered by the Supervisory Authority.
- (2) After registration of the pension plan with the Supervisory Authority amendments thereto may be made only with a written consent of the Supervisory Authority.
- (3) A written consent of the Supervisory Authority for amendments to the pension plan shall not be required, if amendments thereto are made due to the change of, the firm name or legal address of the Pension Fund, the external asset manager, if outsourced, or custodian or the Executive Authority. In such case amendments to the pension plan shall enter into effect on the day following approval thereof, and the amendments shall, within seven days after approval of amendments, be submitted to the Supervisory Authority.
- (4) In order to receive a permit for making amendments to the pension plan, the State Pension Fund or the Private Pension Fund shall submit the following documents to the Supervisory Authority:
  - a. an application regarding making of amendments to the pension plan;
  - b. a motivated request regarding the necessity of amendments to the pension plan;
  - c. amendments to the pension plan;
  - d. the text of the pension plan containing amendments.
- (5) The Supervisory Authority shall examine an application regarding making of amendments to the pension plan and take a decision within 30 days after all the documents specified in this Law, which are necessary for taking of the decision and which have been prepared and developed in accordance with the requirements of regulatory enactments, are received.
- (6) If amendments to the pension plan provide for changes in investment rules, increasing the administrative costs or the amount of remuneration to be paid to the external asset manager, if outsourced, or custodian, the State Pension Fund or the Private Pension Fund shall determine that amendments to the pension plan shall enter into effect not earlier than six months after a permit of the Supervisory Authority to make amendments to the pension plan has been received and the participants of the relevant the pension plan have been informed regarding amendments to the pension plan.
- (7) The State Pension Fund or the Private Pension Fund shall prepare and submit information regarding the investment policy of the relevant the pension plan to the Supervisory Authority in accordance with investment provisions of the relevant the pension plan.
- (8) The State Pension Fund or the Private Pension Fund regularly, not less frequently than once every three years, evaluate the specified investment policy and submit to the

Supervisory Authority a detailed description of the pension plan investment policy to be implemented in future.

- (9) The State Pension Fund or the Private Pension Fund shall submit information regarding changes in the pension plan investment policy to the Supervisory Authority within 3 working days.

#### **Article 18. Investment Rules and Principles for Investments of Pension Plan Assets Managed by the State Pension Fund and the Private Pension Funds**

- (1) The State Pension Fund and the Private Pension Funds, when investing the pension plan assets, shall follow prudent person principle and act solely in the interests of the pension plan participants, as well as observe precautionary and diversification principles which ensure the reduction of risk, security of investments, quality and liquidity in accordance with the rules of the pension plan, and shall implement such investment policy which is aimed towards the growth of funded part pension capital.

- (2) The pension plan assets may be invested in the following financial instruments:

1) securities or money market instruments issued and guaranteed by the government and international financial authorities if such securities or money market instruments have been issued and guaranteed by:

a) the Republic of Azerbaijan;

b) a Member State of the Organisation for Economic Co-operation and Development the long-term credit rating of which in foreign currency according to the evaluation of international rating agencies conforms to the investment category (hereinafter – OECD), or;

c) international financial authorities where at least one of OECD countries is a member;

2) securities or money market instruments issued and guaranteed by municipalities, if:

a) such securities or money market instruments have been issued or guaranteed by the municipalities of Republic of Azerbaijan, or a municipalities of OECD, and;

b) such securities or money market instruments conform to the requirements specified in Paragraph (2) Clause 3 of this Article<sup>3</sup>;

3) the shares of commercial companies and other capital securities (hereinafter– equity securities) or debt securities of commercial companies if such securities:

a) are included in the registered regulated markets of the Republic of Azerbaijan;

b) are included in the official or comparable thereto listing of a stock exchange (regulated market) registered in OECD and the referred to stock exchange is a full member of the International Stock Exchange Federation, and;

c) are not included in the regulated markets referred to in Sub-clauses “a” and “b”, but in the issuance of securities regulations it is provided that the securities therein shall be included within a year from the day when the subscription for the receipt of such securities has commenced. If the referred to securities are not included in the regulated markets referred to in Sub-clauses “a” and “b” within a year from the day when the subscription for the receipt of such securities has commenced, it shall be the duty of the Pension Fund to repurchase these securities for a price which conforms to the purchase value thereof;

4) term deposits in a credit institution which has received a licence to operate the credit institution and to which it is permitted to provide financial services in the Republic of Azerbaijan or in OECD;

5) open-ended investment fund if an investment fund has been registered in the Republic of Azerbaijan or in OECD;

6) alternative investment fund if an alternative investment fund has been registered in the Republic of Azerbaijan or in OECD;

7) derivative financial instruments, if:

a) such derivative financial instruments that are included in the registered regulated markets of the Republic of Azerbaijan or in OECD and the referred to stock exchange is a full member of the International Stock Exchange Federation, and;

b) a credit institution which has received a licence to operate the credit institution and to which it is permitted to provide financial services in the Republic of Azerbaijan or in OECD has assumed obligations included in such a derivative financial instrument.

(3) The pension plan assets shall be invested in compliance with the following investment restrictions:

1) the total amount of investments in securities or money market instruments issued or guaranteed by one state or an international financial institution may not exceed 35 per cent of funded part assets that are managed and invested in accordance with a systematised set of provisions developed by the Pension Fund which is set out in the pension plan. The referred to restriction may be exceeded when performing investments in the transferable securities issued by the Republic of Azerbaijan as well as if the of the pension plan asset have securities or money market instruments from six or more issues of one issuer and the value of securities or money market instruments of each individual issue does not exceed 20 per cent of the pension plan assets, as well if the value of the pension plan assets are less than AZN 200,000;

2) the total amount of investments in securities or money market instruments issued or guaranteed by one OECD municipality may not exceed 10 per cent of the pension plan asset. This restriction shall not apply to investments in the transferable securities issued by municipalities of the Republic of Azerbaijan;

3) the investments in equity securities of one issuer may not exceed 5 per cent of the pension plan assets and concurrently 5 per cent of the equity capital and number of voting stocks of the relevant issuer;

4) investment in debt securities of one issuer may not exceed 10 per cent of the pension plan assets and concurrently 10 per cent of the debt securities of one issuer. This restriction shall not apply to securities referred to in Paragraph (3), Clause 1 of this Article;

5) total amount of investments in securities referred to in Paragraph (2), Clause 3, Sub-clause “c” of this Article may not exceed 20 per cent of the pension plan assets;

6) deposits in one credit institution may not exceed 10 per cent of the pension plan assets. This restriction shall not apply to claims against a Custodian;

7) the investments in one open-ended investment fund may not exceed 10 per cent of the pension plan assets and 30 per cent of net assets of such investment fund;

8) the investments in financial instruments issued by companies that are a part of one group with the Pension Fund may be made only through intermediation of a stock exchange (regulated market), and investments in such securities may not exceed 5 per cent of the pension plan assets;

9) the investments in investment funds managed by a company that is in one group with the Pension Fund may not exceed 15 per cent of the pension plan assets;

10) the total amount of investments in securities or money market instruments issued by one company or one group of companies may not exceed 10 per cent of the pension plan assets;

11) deposits in one credit institution or in credit institutions contained in one group and investments in transferable financial instruments issued by the same credit institution or credit institutions contained in one group in total may not exceed 15 per cent the pension plan assets. This restriction shall not apply to claims against a Custodian;

12) investments in equity securities, alternative investment funds and open-ended investment funds that may make investments in equity securities or other financial instruments of equivalent risk may not exceed 50 per cent of the total assets of the pension plan;

13) investments in derivatives may be performed only for risk reduction purposes to ensure against the risk of fluctuations in the value of the specified the pension plan asset, which may be caused by changes in the price of asset or exchange rate, and only then if the Pension Fund has submitted to the Supervisory Authority regulations in which is described in detail the management policy and the derivatives valuation methods;

14) investments in alternative investment funds may not exceed 10 per cent of the pension plan assets;

15) when using the pension plan asset in transactions with the sale of assets with repurchase, liabilities arising from such transactions may not exceed 50 per cent of the pension plan assets. Such transactions may only be performed for ensuring the short-term liquidity of the pension plan for a period of time up to three months.

(4) When making investments in derivatives, the following provisions shall be met:

1) it has been specified in the investment policy approved by the Pension Fund;

2) the Pension Fund has created a corresponding system for the preparation of reports, risk management and control, which ensures continuous, precise and objective evaluation of derivative financial instruments;

3) the relevant investments are made to secure against the risk of specific fluctuations in value of the pension plan asset, which may occur upon changing of the price of the



relevant asset or currency exchange rate, or to ensure an efficient management of the portfolio;

4) the derivative financial instruments are included in the official listing of stock exchanges (regulated markets) referred to in Paragraph (2), Clause 2, Sub-clause “b” of this Article or the liabilities included in the financial instrument have been undertaken by a credit institution which is entitled to provide financial services in the Republic of Azerbaijan or OECD;

5) investments in derivative financial instruments issued by one issuer (the total sum of transactions with one partner of transactions) shall not exceed 5 per cent from the pension plan assets.

(5) Companies included in one group within the meaning of this Section are commercial companies the annual accounts of which are consolidated in accordance with international accounting standards.

(6) The open currency position of the pension plan shall not exceed:

- 1) in an individual foreign currency– 10 per cent of the pension plan assets;
- 2) in total in all foreign currencies – 20 per cent of the pension plan assets.

(7) The Supervisory Authority shall determine the procedures for the calculation of the open position of foreign currency.

(8) The Pension Fund is prohibited to:

1) invest the pension plan assets in real estate, except investments in alternative investment funds, which may invest in real estate;

2) the pension plan assets may not be used for taking loans and it is prohibited to issue loans from pension plan assets, as well as to issue guarantees from the pension plan asset.

(9) The investment restrictions specified in this Law, which relate to investments in transferable debt securities of one issuer or in financial market instruments, as well as in investment certificates of one open investment fund, may be exceeded if these excesses have arisen due to fluctuations in the investment value or if it has not been possible to determine or calculate the amount or value of the transferable securities or financial market instruments, as well as the value or number of investment certificates or shares issued or in circulation at the time of performing the investment.

(10) The violations of the investment restrictions specified in this Law shall not revoke the validity of the relevant transaction, but the Pension Funds has an obligation to reimburse all losses which have occurred to the participants of the pension plan and third persons due to such operations, except the cases specified in Paragraph 9 of this Article.

(11) The Pension Funds shall, immediately, but not later than on the following working day, notify the Supervisory Authority in writing regarding violations of the investment restrictions, as well as regarding measures for the prevention of such violations, indicating the time period for the elimination of the violations.

(12) The Pension Fund has a duty:

- 1) in accordance with investment provisions of the relevant the pension plan, to prepare and submit to the Supervisory Authority information regarding the investment policy of the relevant pension plan;
- 2) regularly, not less frequently than once every three years, to evaluate the investment policy specified and to submit to the Supervisory Authority a detailed description of the pension plan investment policy to be implemented in future;
- 3) to submit immediately (not later than within three working days) information regarding changes in the pension scheme investment policy to the Supervisory Authority.

(13) The principles for investment of the pension plan assets, the methods for determination of risks related to investments and the risk management system must be determined in the investment policy of the pension plan. The minimum information to be indicated regarding the investment policy shall be as follows:

- 1) the objectives and conditions of the investment policy;
- 2) strategic asset allocation (by asset classes, geographies, maturities, sectors, currencies);
- 3) tactical asset allocation (by asset classes, geographies, maturities, sectors, currencies);
- 4) the general policy for individual security selection;
- 5) quantitative restrictions of investments, compliance with them and control thereof;
- 6) the limit, upon reaching which holding of the specific type of asset is terminated or restricted;
- 7) whether it is intended to use the derivative financial instruments, to enter into purchase agreements with repurchase or reverse repurchase conditions;
- 8) if using of derivative financial instruments is intended – the general policy for the use of derivative financial instruments, the methods for assessment of derivative financial instruments and the risk management policy, as well as the economic impact of the use of derivative financial instrument on investment portfolio;
- 9) the division of responsibility in decision-making process;
- 10) the methods for determination, control and management of risks;
- 11) the criteria, by which return on investments is assessed;
- 12) a description of the policy of voting in relation to investments, which allows participation in decision-making regarding investments, also the procedure for decision-making regarding the use of the voting rights in investments;
- 13) information regarding the Custodian and the Asset manager (if external asset manager is used), as well as the methods for the assessment of activities thereof;
- 14) the policy for the prevention of the potential conflict of interests, in which the way of ensuring that the investments of the pension plan asset are done only in the interests of funded part participants will be ensured by the Pension Fund in case of a potential conflict of interests;

15) if the credit ratings provided by external credit rating bodies (rating agencies) are used for the assessment of investment credit risk – the fact that such credit ratings are not used mechanically and as the only means for the assessment of credit risk.

(14) The Pension Fund shall ensure the creation of a corresponding reporting and control system in order to ascertain that the asset management of the pension plan asset is done in accordance with the policy and procedures specified by the Pension Fund.

(15) The Pension Fund shall provide the pension plan participants with free access to information regarding the investment policy, as well as place the referred to information in the Internet home page of the relevant Pension Fund if such has been developed, or in the Internet home page of any stockholder of the Pension Fund if the Pension Fund does not have its own Internet home page.

(16) The Pension Fund shall, at least once a year, perform the stress test of the investment portfolio of the pension plan, in which the potential adverse development scenarios shall be assessed and documented. The sensitivity tests and scenario analysis shall be used for the stress test. Sensitivity tests shall be performed in order to determine the impact of unfavourable changes of an individual factor or number of factors on the pension plan investment portfolio, detecting the cause for such extraordinary, but potentially unfavourable events or changes.

(17) The Pension Fund shall approve the results of the stress test and take a decision on activities to be carried out in case of setting in of the events or changes referred to in the stress test. A stress test approved by the Pension Fund and a decision on activities to be performed shall be submitted to the Supervisory Authority.

(18) The Supervisory Authority has the right to determine additional requirements and the procedures, by which stress test shall be carried out, specifying the potential factors and scenarios to be tested.

(19) In addition to that specified in Paragraph 18 of this Article the Supervisory Authority has the right to request that the Pension Fund performs and submits an ad hoc stress test to the Supervisory Authority.

#### **Article 19. Concept of State Conservative Pension Plan Provided by the State Pension Fund**

The State Pension Fund shall develop the pension plan providing conservative investment strategy (hereinafter – the state conservative pension plan) which complies with following criteria:

- a. The state conservative pension plan should follow rules and principles described in Article 18 of this law;
- b. The state conservative pension plan is prohibited to make investments in equity securities, alternative investment funds and open-ended investment funds that may make investments in equity securities or other financial instruments of equivalent risk;
- c. Investments in currencies unmatched to obligations may not exceed 20% in total pension plan assets;
- d. securities or money market instruments have to be issued or guaranteed by the State of Azerbaijan or OECD member state with long-term foreign currency credit rating that conforms to investment category according to the evaluation

of international rating agencies or state of origin of the issuer shall be Republic of Azerbaijan;

- e. investment restrictions provided by Article 18 and 19 of this law may be exceeded for the first year of operations if the value of the pension plan assets is less than 200,000 AZN if complying with condition that investments are performed only in securities or money market instruments issued and guaranteed by the Republic of Azerbaijan and deposits in credit institutions in the Republic of Azerbaijan.

#### **Article 20. Governance Rules for the State Pension Fund and the Private Pension Funds**

- (1) When carrying out the tasks laid down in this law the Pension Fund and the custodian shall act honestly, fairly, professionally, independently and in the interest of the pension plan participants. The Pension Fund shall not carry out activities which may create conflicts of interest between the Pension Fund itself and the pension plan participants, unless the Pension Fund has functionally and hierarchically separated the performance of its asset management function from its other potentially conflicting functions and tasks, and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the participants.
- (2) The Pension Fund shall have in place an effective system of governance which provides for sound and prudent management of its activities. That system shall include an adequate transparent organisational structure with a clear allocation and appropriate segregation of responsibilities and an effective system for ensuring the transmission of information. The system of governance shall be subject to regular internal review.
- (3) The Pension Fund shall adopt written policies in relation to risk management, internal audit and, where relevant, outsourcing or other activities concerned, and the Pension Fund ensures that those policies are implemented. The policies shall be reviewed annually and shall be adapted in view of any significant change in the system or area concerned.
- (4) The Pension Fund shall ensure effective internal control system in place. That system shall include administrative and accounting procedures, an internal control framework, and appropriate reporting arrangements at all levels of the Pension Fund.
- (5) The Pension Fund shall employ appropriate and proportionate systems, resources and procedures.
- (6) Persons authorised to take decisions on behalf of the Pension Fund and persons responsible for internal audit, compliance and risk management shall meet the following criteria:
  - a. he or she has sufficient competence in the field, for which he or she will be responsible, that the Pension Fund would be able to carry out the accumulation of pension benefits independently, professionally, in good quality and in accordance with the requirements of regulatory enactments;
  - b. he or she has a higher education and relevant professional experience of not less than three years;
  - c. he or she has an excellent reputation;
  - d. he or she has not been suspended the right to perform commercial activities.
- (7) Persons authorised to take decisions on behalf of the Pension Fund and persons responsible for internal audit, compliance and risk management may not be authorised in the following cases:

- a. he or she has been convicted of intentional bringing of a commercial company to insolvency or bankruptcy (fraudulent bankruptcy) or of committing another intentional criminal offence;
  - b. he or she has been convicted of committing an intentional criminal offence, however, released from serving of the punishment due to the period of limitation, clemency or amnesty;
  - c. he or she has been held criminally liable for committing an intentional criminal offence, however, the criminal matter against him or her has been terminated for reasons other than exoneration.
- (8) The person in charge of the State Pension Fund or chairman of the Private Pension Fund shall remove the persons referred to in Paragraph (3) of this Article from the office without delay, if they do not conform to the requirements of this Article upon its own initiative or upon the request of the Supervisory Authority.
- (9) Within the meaning of this Law a conflict of interests is a situation when the Pension Fund and the persons related thereto take decisions on transactions with the pension plan assets and concurrently perform the execution of such decisions or the control of execution thereof.
- (10) For the prevention of a conflict of interests persons authorised to take decisions on behalf of the Pension Fund and persons responsible for internal audit, compliance and risk management shall refrain from taking decision on transactions of the Pension Fund, in which such persons find or may find themselves in a conflict of interests, as well as notify head of internal audit service about such transactions.
- (11) If the Pension Fund, the external asset manager, the custodian, or a provider of external services are related persons belonging to the same consolidation group of companies, the Pension Fund shall develop the policy for prevention of conflict of interests situations, which ensures timely identification and management of the potential conflict of interests situations. The policy for the prevention of conflict of interest's situations shall include the action of employees for the prevention of conflict of interests situation, including:
- a. a restricted access to information, which is not necessary for the performance of work duties and which causes or may cause a conflict of interests;
  - b. a different organisational subordination that ensures mutual independence of the structural units thereof, which perform such activities that cause or may cause a conflict of interests;
  - c. that the conditions for transactions with persons related to the Pension Fund are not different from the conditions in relation to similar transactions of the Pension Fund with persons not related to the Pension Fund and is not in contradiction with the pension plan and the interests of the participants thereof.

#### **Article 21. Administration of Individual Accounts by the Pension Fund**

- (1) The Pension Fund shall ensure the calculation and record-keeping of the pension capital accumulated to each the pension plan participant.
- (2) All contributions, investment income and fees deducted shall be registered in individual accounts.
- (3) The independent auditor of the Pension Fund shall provide annually an opinion whether individual accounts are maintained in accordance with the requirements of this Law and other regulatory enactments, regarding with statutes of the Pension Fund and provisions of the pension plan and participating contract.

- (4) Funded part pension capital shall be calculated at least on quarterly basis according to rules and procedures determined by The Supervisory Authority.
- (5) The Pension Fund provides to the Executive Authority all information on individual accounts necessary for the maintenance of the personal accounts administrated by the Executive Authority. Scope and regularity of the information to be provided to the Executive Authority shall be determined in the contract signed by the Pension Fund and the Executive Authority. The Executive Authority has the right to request ad hoc information necessary for the performance of administration function.

## **Article 22. Information Provided to the Pension Plan Participants**

- (1) Concerning the information provided to the participants, Article 8 of the Law of the Republic of Azerbaijan On Personal Accounting in the State Social Insurance System shall apply.
- (2) The Executive Authority shall make available to the participant the copy of the pension plan either before registration according to Article 5 of this law or immediately afterwards.
- (3) The Pension Fund shall, not later than within five working days after permit of the Supervisory Authority for making of amendments to the pension plan according to Article 17 of this law has been received, inform the participants of the relevant pension plan thereof.
- (4) Upon the participant's request, the Pension Fund shall provide:
  - a. detailed information regarding the actual investment portfolio;
  - b. annual accounts and annual reports of the Pension Fund and particular the pension plans, if it is providing more than one the pension plan;
  - c. up-to-date information regarding the investment policy, as well as place where the information referred to is available on the internet home page.
- (5) The Pension Fund shall, at least once a year, send a written statement of individual account on relevant accounting period to each participant of the pension plan containing information on her or his personal account with regard to Article 9 of this law. The following shall be indicated in the statement:
  - a. the contributions made in favour of the pension plan participant;
  - b. funded part pension capital accumulated;
  - c. the total sum of deductions applied to participant, which includes deductions to the Pension Fund, to the external asset manager (if applicable), to the custodian, to the Supervisory Authority and other eligible deductions;
  - d. the given name and surname of such independent auditor or the legal name of such commercial company of independent auditors, who or which has examined the financial accounts of the Pension Fund;
  - e. information regarding whatever the opinion of the independent auditor or commercial company of independent auditors is without comments, with comments or a negative opinion has been provided;
  - f. information regarding where the pension plan participant may be acquainted with the annual accounts of the pension plan;
  - g. Information regarding to any changes related to appointing of an auditor, external asset manager (if applicable) or custodian, as well as provide other substantial information regarding activities of the Pension Fund.
- (6) In addition to that specified in Paragraph 4 of this Article, the Pension Fund shall ensure that each month the pension plan participant has access to information regarding operational results of the pension plan (investment return). The Pension Fund may make

public the relevant information on the Internet home page thereof or also choose other appropriate information communication tool or place for making the information public.

### **Article 23. Risk Mitigation Mechanisms**

- (1) The pension plan participant without any additional conditions has the right to all the funded part capital accumulated in his or her individual account.
- (2) Monetary assets, financial instruments and other property of the pension plans shall be kept, recorded and managed separately from the funds of the Pension Fund, custodian, as well as external asset manager itself (if applicable) and other funds under management.
- (3) If the Pension Fund, custodian or external asset manager has been declared insolvent or is being liquidated, the funds of the pension plans may not be included in the property of custodian, external asset manager or the Pension Fund.
- (4) Contributions of the pension plan participant made to the Pension Fund shall be immediately (but not later the following working day after the day when contributions were transferred into the account opened for specific the pension plan), transferred into individual account of the pension plan participant.
- (5) The pension capital accumulated in an individual account may not become the property of external asset manager, custodian or the Pension Fund in any case.
- (6) The pension plan participant shall be ensured a possibility of continuing participation in the pension plan, receiving the funded part pension capital and the information to be provided for the pension plan participants specified in this Law. This should also apply when the pension plan participant moves for permanent residence to a foreign state after he or she has commenced participation in the pension plan, as long as this is in accordance with Article 4 of this law.

## **CHAPTER VI. ASSET MANAGEMENT AND CUSTODIAN FUNCTION**

### **Article 24. Asset Management of the Pension Plan Assets**

- (1) The asset management function of pension plan assets shall ensure implementation of the investment strategy approved for each the pension plan in the compliance with the provisions of the pension plan, perform transactions with financial instruments and other transactions with the pension plan assets in regarding with requirements of this Law and the pension plan registered by the Supervisory Authority.
- (2) Asset management function includes the following services:
  - a. managing of the Pension Fund investments;
  - b. ensuring administrative management of the pension plan that includes the following activities:
    - i. handling legal matters and accounting of the pension plan,
    - ii. providing information upon request of participants and other institutions involved,
    - iii. calculation of the funded part pension capital,
    - iv. monitoring compliance with the regulatory requirements governing the operation of the pension plan,
    - v. preparation of investment orders according to contractual obligations,
    - vi. conducting accounting of transactions in the pension plan assets,
    - vii. maintaining individual accounts register;

- c. marketing of the pension plan (advertising, distribution of the pension plan, market research and other similar services).
- (3) The pension plan assets may be managed by the Pension Fund itself or by another legal entity, competent and in capacity to provide asset management.
- (4) The pension plan assets may be managed by the State Pension Fund in accordance with the provisions of the Article 15 or by the Private Pension Funds in accordance with the provisions on the law on the Private Pension Funds concerning asset management function as far as it does not contradict the requirements of this law.
- (5) The organisational structure of the Pension Fund shall ensure establishment of a separate independent department responsible for asset management to ensure elimination of conflict of interest and introduction of the appropriate risk mitigation mechanisms.

#### **Article 25. External Asset Management**

- (1) Asset management function might be delegated to one or several external asset managers. However, the Pension Fund always stays liable for the proper execution of the asset management function.
- (2) The Private Pension Funds, in this case, have as generally provided to follow the rules on outsourcing as provided in the Law on Private Pension Funds except special rules in the following paragraphs of this Article apply.
- (3) Provisions for the management of the pension plan assets shall be provided in a contract between the Pension Fund and external asset manager. The contract with external asset manager and any amendments therein shall be submitted to the Supervisory Authority within three working days after signing thereof. The agreement comes into force only after approval by the Supervisory Authority.
- (4) The minimum information to be indicated in the contract with external asset manager of the pension plans shall be as follows:
  - a. a description of the service to be received;
  - b. precise requirements for the scope and quality of the service;
  - c. the rights and duties of the Pension Fund and external asset manager, including:
    - i. the right of the Pension Fund to permanently supervise the quality of the provision of the service,
    - ii. the right of the Pension Fund to give an external asset management instructions to be mandatorily executed in issues, which are related to the execution of the asset management in good faith, good quality, timely manner and corresponding to regulatory enactment,
    - iii. the right of the Pension Fund to request that the external asset manager of the pension plans, upon the receipt of a written request, terminates a contract regarding management of the pension plans without delay;
  - d. the procedures for exchange of information, which ensure the fulfilment of the duties of the external asset manager of the pension plans specified in this Law and the preparation of operational reports of the Pension Fund;
  - e. the provision that the contract will cease to be in effect only after an external asset manager has transmitted asset management to the Pension Fund itself or to the new external asset manager.
- (5) In addition to the requirements specified in this Law the external asset manager shall comply with requirements of the regulatory enactments regulating asset manager



activities in relation to the duties in providing asset management services, acting with care and providing best results of execution.

- (6) The external asset manager shall be liable for compliance of transactions involving the accumulated pension capital in the Pension Fund with the requirements of this Law and provisions of the pension plans registered by the Supervisory Authority.
- (7) The Supervisory Authority is entitled to request that the Pension Fund terminates a contract with external asset manager, if the Supervisory Authority detects that the external asset manager does not comply with the requirements of this Law or regulatory provisions of the Supervisory Authority.
- (8) External asset manager might delegate part of asset management services to one or several sub-service providers with relevant competences to ensure proper execution of the function. However, external asset manager always stays liable for the service provision.
- (9) Delegation of asset management services to the third parties is allowed only if delegation of services to the third parties is provided in the contract between the Pension Fund and external asset manager and only after prior approval by the Pension Fund.
- (10) Transfer of the services to the third parties shall not release the external asset manager from the liability provided for in the law and in the agreement between the Pension Fund and external asset manager.

#### **Article 26. Custodian of the Pension Plan Assets**

- (1) Transactions of the pension plan assets shall be performed through intermediation of a custodian, entering into a custodian agreement therewith. The contract with the custodian and any amendments therein shall be submitted to the Supervisory Authority within three working days after signing thereof.
- (2) Custody function shall be provided by a commercial bank which is entitled to provide investment services and non-core services in the Republic of Azerbaijan, including holding of financial instruments, and operates independently from the Pension Fund and solely in the interests of the pension plans participants.
- (3) The Pension Fund shall freely choose the custodian by concluding a written contract with the Custodian.
- (4) The custodian contract shall include at least the following requirements:
  - a. a description of the service to be received;
  - b. precise requirements for the scope and quality of the service;
  - c. procedure for exchange of information between the custodian and the Pension Fund;
  - d. description of duties of the custodian in the safe-keeping as well as liabilities toward the Pension Fund;
  - e. oversight function envisaged over activities of the asset management;
  - f. rights of the Pension Fund and the Supervisory Authority to require access to all information and documentation at any time;
  - g. regulations on termination of contract if custodian does not comply with any requirements of the legislation or custodian agreement, that are in compliance with chapter 20, § 4 of the Civil Code of the Azerbaijan Republic;
  - h. custodian fees and procedure for reimbursement of expenses.
- (5) Providing custodian services, the custodian shall ensure that:
  - a. the Pension Fund shall open a separate account with the custodian for each the pension plan;

- b. income from the pension plan assets shall be transferred to the account of the relevant pension plan held with the custodian;
  - c. the custodian shall perform transactions and other payments from the account of the pension plan only on the basis of an order by the Pension Fund or external asset manager (if applicable) in accordance with the law, the pension plan rules and the custodian agreement;
  - d. the custodian shall keep the pension plan assets in accordance with the law and the custodian agreement;
  - e. the custodian has to make sure that the net asset value is calculated in accordance with the law, normative acts and the pension plan rules;
  - f. the custodian has to fulfil orders of the Pension Fund or external asset manager (if applicable) if they do not contradict the law, the normative acts, the pension plan rules and the custodian agreement;
  - g. the custodian has to make sure that the payments specified in transactions with the pension plan assets are duly made;
  - h. the custodian has to provide information upon the Supervisory Authority's request that the custodian has received while performing the functions of a custodian;
  - i. the oversight function shall not be delegated to third parties and should be performed by custodian itself;
  - j. appointment of sub-custodians relates only to safe-keeping function of custodian;
  - k. the safe-keeping function might be delegated to several sub-custodians to ensure proper execution of the function. However custodian always stays liable for assets entrusted to him in custody;
  - l. if the custodian delegates its functions to a third party, such agreement shall be in effect if it has been approved by the Pension Fund and the Supervisory Authority;
  - m. the transfer of the custodian's duties to third parties shall not release the custodian from the liability provided for in the law and the custodian agreement;
  - n. custodian shall avoid potential conflicts of interest or incompatibility that could be an obstacle for appropriate functioning of the safe-keeping and oversight duties;
  - o. besides these general provisions, the Pension Fund is entitled to lay down more detailed rules for the custodian to ensure elimination of the conflicts of interest or incompatibility;
  - p. the custodian shall notify the Supervisory Authority in writing and without delay about actions by the Pension Fund or the external asset manager (where applicable), known to the custodian, which are in conflict with the law, the pension plan rules, investment policy or the custodian agreement. If the custodian receives certain orders by the Pension Fund or the external asset manager, that demand actions by the custodian, that, with regard to the judgement of the custodian, are in conflict with the law, the pension plan rules, investment policy or the custodian agreement or if there are reasonable doubts about the legitimacy of such actions, the custodian shall prevent from execution of such orders and report those orders to the Supervisory Authority.
- (6) The custodian shall be fully liable to the pension plan participants, the Pension Fund and third persons for losses, which have been caused by violation of the Law or the

custodian agreement or lawful orders of the Pension Fund intentionally or through negligence or has performed its duties negligently.

- (7) In case the custodian has consented to a transaction which does not conform to the provisions of this Law or has failed to submit an objection regarding a violation according to Paragraph (6) of this Article, the custodian and the Pension Fund shall be jointly liable for the losses caused to the pension plan participants.

#### **Article 27. Change of the Custodian and External Asset Manager of the Pension Plan Assets**

- (1) In case the Pension Fund decides to change the custodian or the external asset manager after termination of the contracts, it shall, after entering into a new contract, submit to the Supervisory Authority the new contract within 3 working days and additionally provide information on the regarding the necessity to replace the former custodian or external asset manager.
- (2) The Pension Fund shall, within 30 days after a new contract with the custodian has been entered into, submit to the Supervisory Authority documents, which certify that the new custodian has received all assets accumulated in the relevant pension plan, as well as documents certifying the ownership of the monetary means and other assets. If necessary, the Supervisory Authority is entitled to request relevant documents on the activities of the Pension Fund which has been prepared in accordance with the regulatory enactments regulating development of annual reports of the Pension Funds.

#### **Article 28. Insolvency of Custodian**

If the custodian has been recognised insolvent and bankruptcy procedures have been initiated, or custodian has been deprived of the relevant licence, a new custodian shall be appointed by the Pension Fund and the pension plan assets shall be transferred to the new custodian in accordance with the requirements of Article 27 of this law.

### **CHAPTER VII. STATE SUPERVISION OF OPERATION OF FUNDED PART**

#### **Article 29. Supervision of the Pension Funds and Custodians**

- (1) The Supervisory Authority shall supervise the Private Pension Funds and custodians of the funded part.
- (2) The Supervisory Authority has the obligations:
  - a. to supervise that the Private Pension Funds when managing funded part asset, comply with the requirements of regulatory enactments;
  - b. to supervise that the custodians of the funded part, when keeping the pension plan asset, comply with the requirements of regulatory enactments and;
  - c. to register the pension plan conforming to the requirements specified by Articles 16 and 17 of this law and worked out by the State Pension Fund or the Private Pension Funds.
- (3) The Supervisory Authority shall exchange information with the Executive Authority performing administration function regarding the licencing and cancelation of the licences of the Private Pension Funds when the Private Pension Funds acting under this law have signed the contracts with the Executive Authority.

- (4) The Supervisory Authority shall exchange information on changes in register of the pension plans.
- (5) The Supervisory Authority has the right to perform on-site inspections of the Private Pension Funds providing the pension plans for the funded part and the custodians, and to request documents and information regarding the operation thereof. The Private Pension Funds and custodians have an obligation to provide all necessary information and to present all the documents during such inspections.
- (6) The Supervisory Authority is entitled to call upon the performance of ad hoc stress tests according to Article 18 Paragraph (19).
- (7) The Supervisory Authority on the basis of the reports submitted and inspections performed shall evaluate the stability of the financial standing and solvency of the Private Pension Funds, and the custodians as well as compliance of the pension plan and investment rules and, if necessary, provide corrective measures regarding the improvement, as well as determine a time period for the implementation of the measures.
- (8) The Supervisory Authority may revoke the authorization or approval of asset management functions if the external assets manager's actions are not in compliance with this law and corresponding regulations.
- (9) The Supervisory Authority may enact sanctions and corrective measures to the Private Pension Funds in accordance with the provisions of the law on Private Pension Funds if the Private Pension Funds actions are not in compliance with the requirements of this law.
- (10) If the Supervisory Authority cancels the licence of the Private Pension Fund in order to protect the rights of the participants, it may make a decision to transfer the pension plan of the funded part to another the Pension Fund providing the pension plan with respective investment strategy. The receiving the Pension Fund has the obligation to accept this transfer. The pension plan shall be transferred in accordance with the procedure determined by the Supervisory Authority to perform all activities of substantiated necessity to prevent the reduction of value of the pension plan.
- (11) If the Pension Fund has refused to provide the pension plan and participants whose pension capitals are managed by the relevant the Pension Fund, within three months of the day when the Executive Authority has notified them on the refusal of such Pension Fund, have not submitted to the Executive Authority a written submission regarding the selection of a new the Pension Fund, in accordance with the procedures prescribed by the Supervisory Authority the pension plan shall be transferred to another the Pension Fund.
- (12) The Supervisory Authority shall immediately inform the Executive Authority on its procedure.
- (13) If the ability of the custodian of the pension plan to provide custodial services is restricted by respective the Supervisory Authority or there are other conditions interfering the activities of the custodian the Pension Fund shall immediately but not later than next working day select another custodian and sign the contract with new custodian to immediately transfer the pension plan assets to the new custodian.

### **Article 30. Reporting Requirements for the Pension Funds as Regard Activities on Funded Part**

- (1) The Pension Fund shall, in accordance with procedures determined by the Supervisory Authority, prepare an annual report that provides a true and clear representation regarding the pension plan, accounting of contributions made and

investments. An independent auditor, in accordance with the law on audit services of the Republic of Azerbaijan, approved by the Pension Fund shall audit the report in accordance with international auditing standards.

- (2) An independent auditor has an obligation to notify in writing the Pension Fund regarding deficiencies determined in the audit and to send the copies of his or her notice to the Supervisory Authority and the Executive Authority. If the deficiencies require rapid action, the independent auditor has an obligation to send respective notices immediately.
- (3) To ensure proper supervision of the funded part, the Supervisory Authority is entitled to request the Pension Fund to prepare and submit regular reports in accordance with the regulations issued by the Supervisory Authority regarding the procedures for the preparation and submission of such reports.

### **Article 31. Payments of the Pension Fund for Financing of the Supervisory Authority Activities**

- (1) The Pension Fund shall pay supervisory fee expressed as a per cent from the contributions made by the pension plan participants to the Supervisory Authority for financing of activities thereof.
- (2) Exact level of supervisory fee is set by the Supervisory Authority on annual basis at least by October 1 each year and cannot exceed xx per cent.
- (3) Payments referred to in Paragraph (1) in this Article shall be made every quarter until the 30<sup>th</sup> date of the month following the quarter into account of the Supervisory Authority.
- (4) The Supervisory Authority shall issue regulatory provisions regarding the procedures for the calculation of the payments referred to in Paragraph (1) in this Article and submission of reports.
- (5) Late fees shall be calculated for late transfer of the payments referred to in Paragraph (1) in this Article or transfer in incomplete amount, the amount of the late fee being 0.05 per cent from the unpaid sum for each late day. Late fee is being covered from the resources of the Pension Fund.

## **CHAPTER VIII. OTHER RULES**

### **Article 32. Administration Costs**

The Pension Fund shall ensure that the maximum costs and charges for covering the pension plan expenses including administration, asset management and custodian expenses as well as payments to third persons but excluding supervisory fee, which are deducted from the pension plan asset, do not exceed 2,85 per cent of the average value of the pension plan assets per annum.

### **Article 33. Marketing for the Pension Plan**

- (1) Any public marketing (advertisement) of the pension plan and the services associated thereof in any way may occur only in conformity the rules of the pension plan registered with the Supervisory Authority.
- (2) In placing an advertisement or publicly notifying the regulations of the pension plan, the pension plan advertisement shall indicate:
  - a. the name of the pension plan;
  - b. the name of the Pension Fund and legal address;

- c. the name of the custodian;
- d. a notice that the current investment yield (return) does not guarantee a similar investment yield in the future (if in the advertisement is mentioned the yield of the pension plan).

(3) The pension plan advertisement shall in no way guarantee a profit or a specific level of investment yield (return).

#### **Article 34. Taxation in Relation to the Pension Funds**

The State shall determine special procedures of tax payment in relation to the Pension Funds, activities thereof, as well as investment income and contributions in the Pension Funds, and personal income tax relief.

#### **Article 35. Services Provided by the Private Pension Funds for the Private Pension Benefit Accumulation**

The Private Pension Funds shall be entitled to provide services in accordance with provisions of this law only after the adoption and coming into force of the law on Private Pension Funds.

#### **Article 36. Coming into Force**

(1) Article 8 Paragraph (3) shall come into effect on /date.month.year/. Until /date.month.year/. The expenses of the Executive Authority for the administration of funded part shall be covered from the state budget.

(2) This Law shall come into force on /date.month.year/