



ANNEX 4

Twinning Project AZ/13/ENP/SO/24

Support to the State Social Protection Fund on the introduction of funded element within the insurance-pension system, establishment of non-state pension funds and development of legal framework for regulating their activity

Workshop

Possible solutions for development of multi-level pension system in the Republic of Azerbaijan

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Gesellschaft für
Versicherungswissenschaft
und -gestaltung e.V.



10-11th December, 2014

Concept of reforms of pension provision system in the Republic of Azerbaijan in 2014-2020,
04.11.2014. approved by the President of Republic of Azerbaijan

Development of non-state pension institutions

- additional provision to the mandatory state social insurance

Activation of voluntary funded component of labor pensions

- Introduction of voluntary social insurance

Agenda

Study report – main conclusions

- Economical situation
- Demographical situation and state social insurance system
- Financial and capital market development
- Private Savings market development
- Financial and capital market supervision
- SWOT analysis for building pension savings in Azerbaijan

Proposals on Development of non-state pension funds

- Scheme Structure and governance
- Labor Law and Consumer protection principles
- Regulation and supervision / Asset investment issues/ Risk management and insolvency issues
- The Pay-out phase of fully funded pension options, problems and actual international practice

Proposals on Activation of voluntary component of labor pensions

- Comparison of 3 versions of building funded component of labor pensions taking into account existing state social contribution rate and social budget constraints

Main conclusions from Study report on demographical, economic, financial and capital market situation and social insurance system in Azerbaijan

December 11, 2014, session 11:10-12:30

Goal of Study report

Economic, demographic, state social insurance system

- To understand how **local economy could support pension savings accumulation** – GDP growth, sectors of economy, state budget situation and government debt financing, tax administration capacity and shadow economy, exchange rate stability
- To understand **state social insurance system stability regarding to demographical processes** in country and evaluate possible options of the state funded pensions component introduction

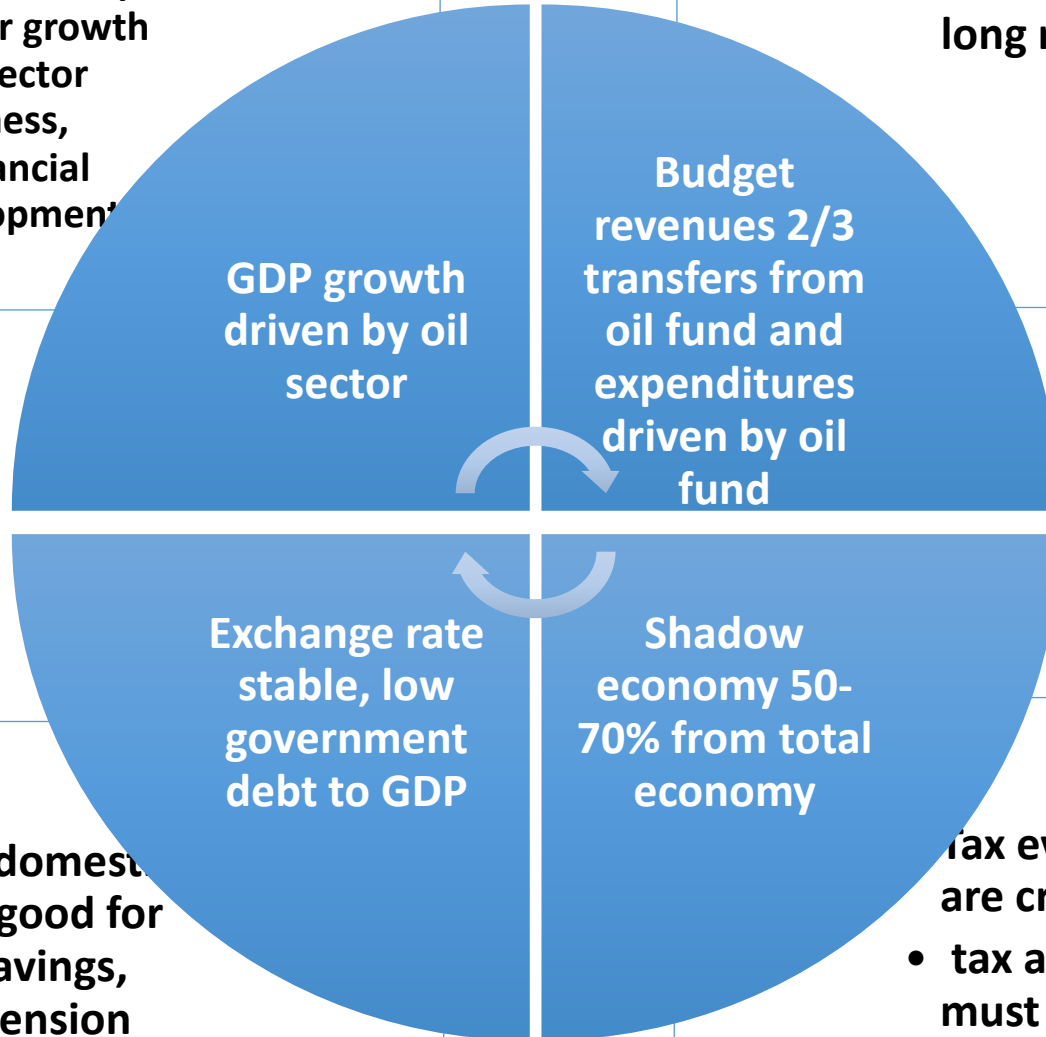
Private Savings market, Financial and capital market and it's supervision

- To understand how **tax burden can influence private pension savings** market
- To understand existing **financial and capital market infrastructure and financial instruments** as well as future development needs (banks, life insurance companies, financial instruments used for capital financing)
- To understand structure and responsibilities of **financial and capital market supervision** for non-state pension savings development (institutions for banks and life insurance companies supervision, as well as securities market supervision)

Study report - Economic situation

- Challenge to develop non-oil sector growth and private sector competitiveness, including financial sector development

- Not sustainable in long run



- Stability of domestic currency – good for long term savings, especially pension savings

- tax evasion issues are crucial
- tax administration must be strengthen

The Global Competitiveness Report
2012–2013



39 position from 148 countries

Exposure to adverse oil sector developments

Implicit liabilities associated with pension obligations

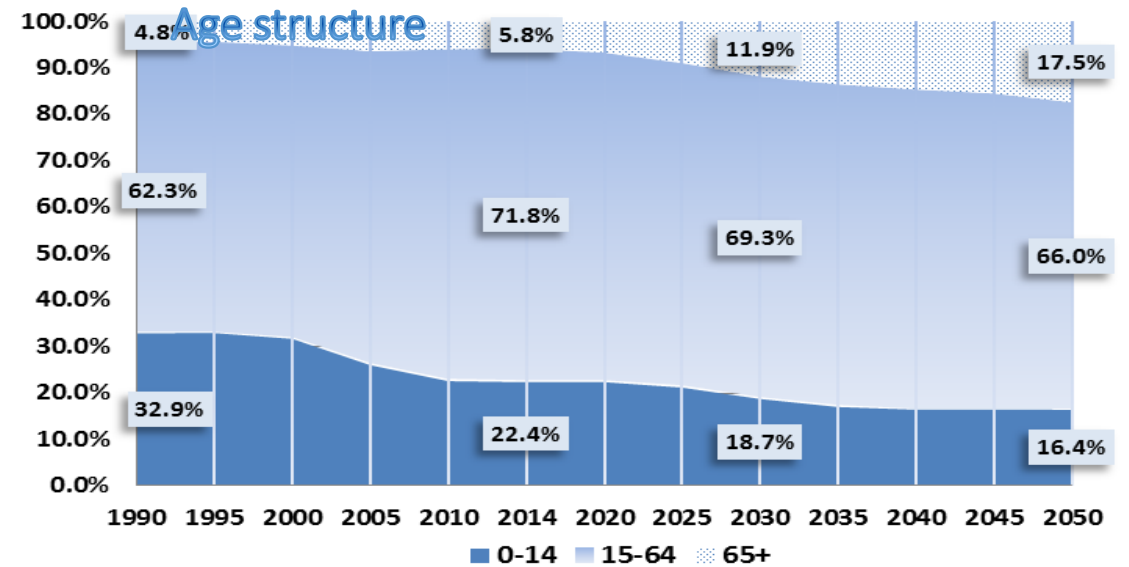
IMF

Activities of the State Oil Company (SOCAR)

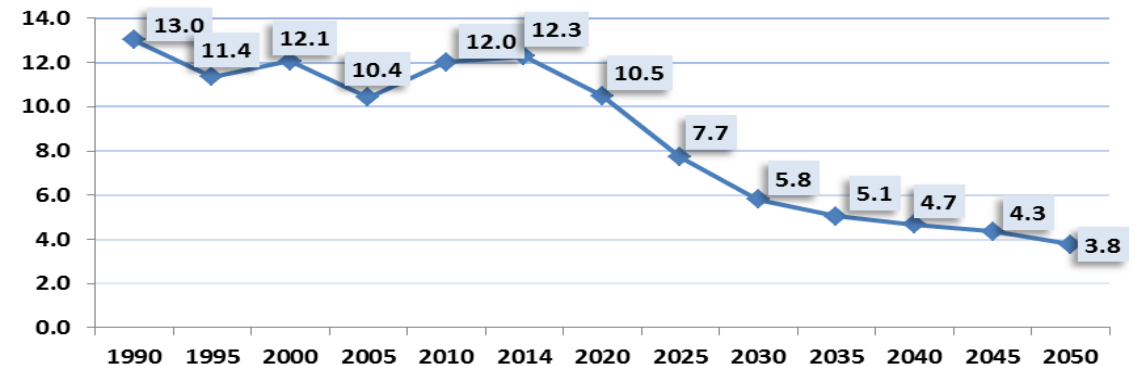
Activities of the systemic and largely state-owned bank IBA

Demographic situation (Study report)

- Relatively young population with share of working age people – almost 72% and share of people 65+ – less as 6% (in 2013)
- Projected increase of the share of people in the age 65+ wherewith sharp growth in old age dependency ratio would leave an impact on financing of pension expenditure in the future
- The timely established state funded pension component of the pension system would reduce the state liabilities for future pensioners and stimulate financial sustainability of pension system



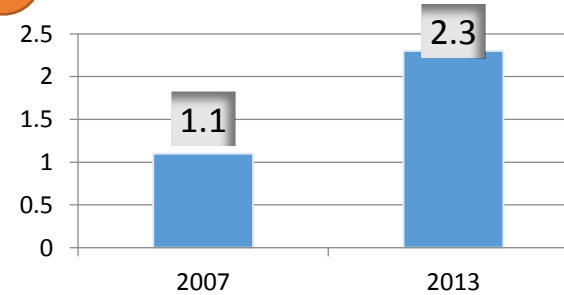
Number of persons age 15-64 per one person age 65+ (persons)



State social insurance system (Study report)

- Successful social insurance system's reform
- High share of people outside of the social insurance system
- Basic part of labour pension break link between contributions and benefits
- Large group of people who pensions based on non-insurance principles
- Replacement rate of the insured labour pension part is critically small (12.5% of gross payroll for pension capital)
- The pension system is not financially sustainable for the long term

1 The number of contributors (mln)

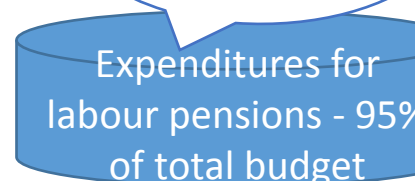


There is a large proportion of undeclared taxable person (the gap – 52.4% in 2013)

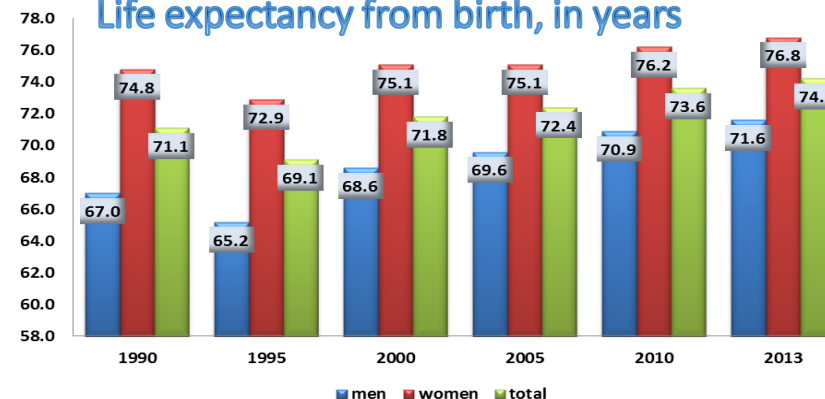
2 Labour pension proportion (2013)



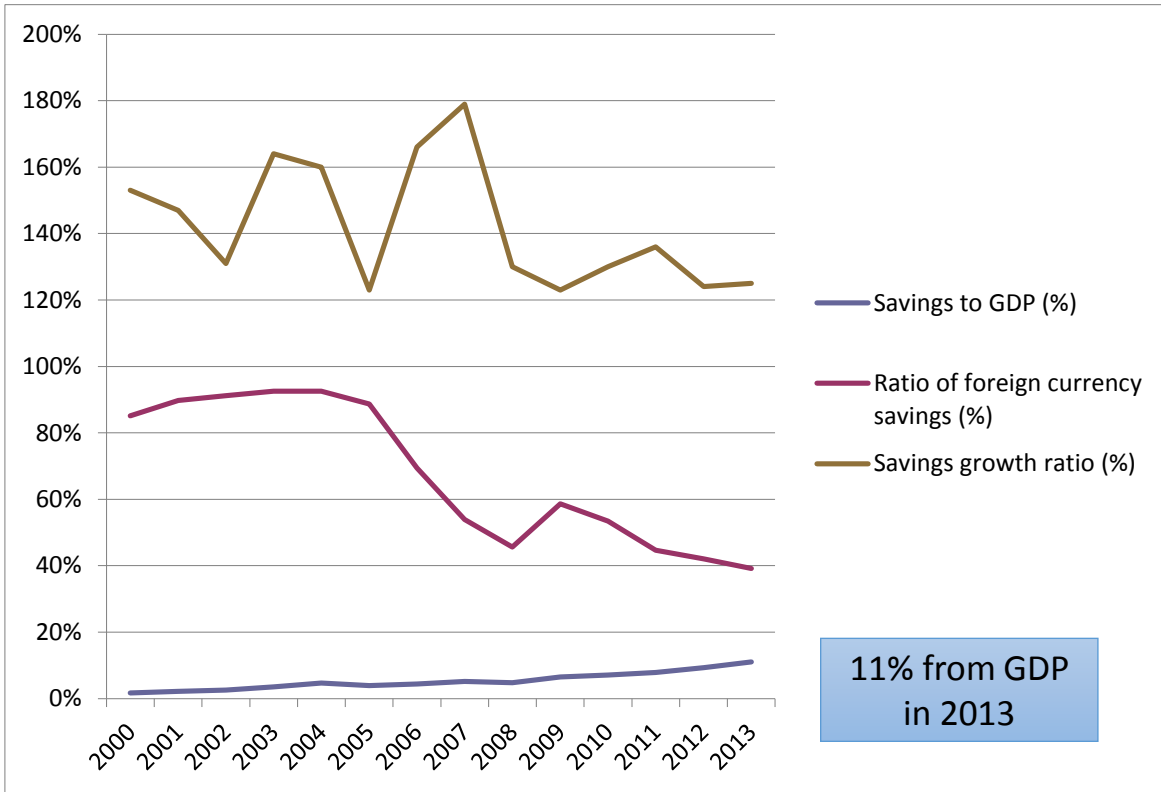
State budget dotation ~40%



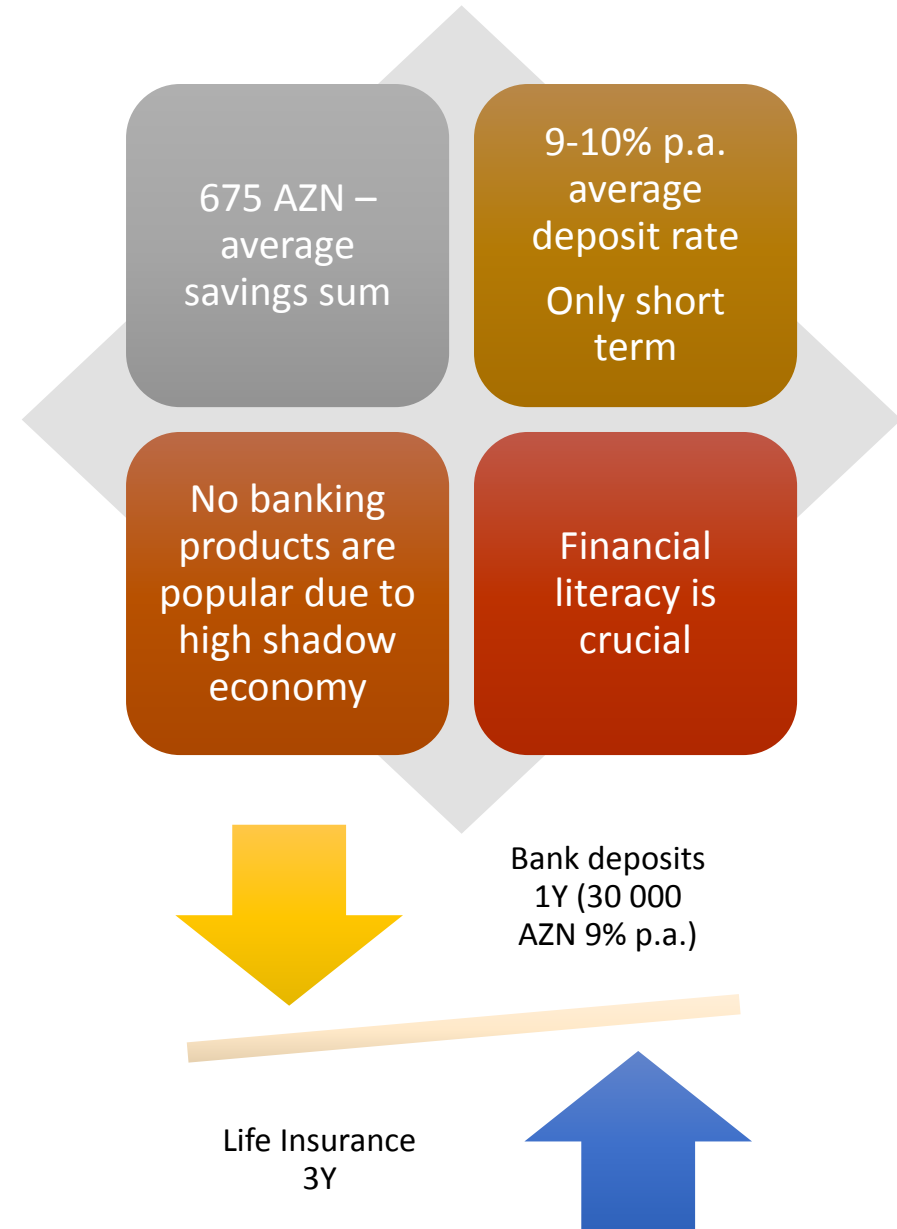
4 Life expectancy from birth, in years



Study report - Private Saving's market development



There would be social (inheritance or beneficiary) and financial stimulus needed (like tax advantages) to promote funded pensions and long-term life insurance savings development in Azerbaijan



Study report - Financial and capital markets development

Despite the fact that capital market is relatively underdeveloped, it should provide **sufficient scope and depth for the management of country's pension resources**, especially at the initial stages

- Government bonds, mortgage bonds, corporate bonds and bank deposits

The development of **pension management market would ensure accumulation of country's long term capital resources** that can be effectively used for the financing of country's economy

- Stock market, corporate bonds, infrastructure projects, industrial investments, real estate investments, private equity and venture capital

Study report - Financial and capital markets supervision

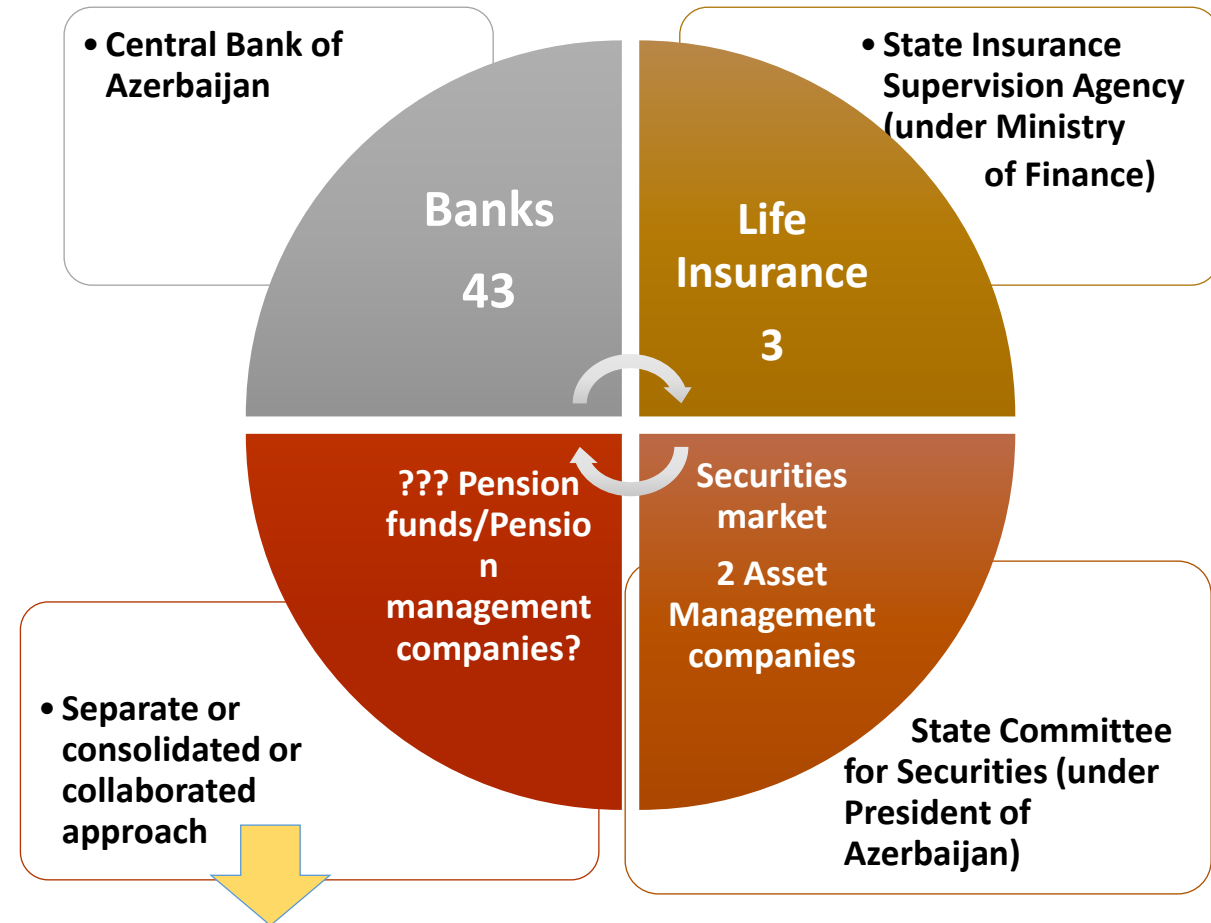
Sound, modern and independent supervision is important component of the successful functioning of pension management function and protection of the interests of the members

Financial sector risks - the weak position and supervision of the systemic public bank (IBA) could compromise the stability and soundness of the system/ lack of competition/ capital issues

For the successful activities of the pension business there are three important components that should be considered:

- Administration of pension funds
- Asset management
- Custodianship

While single body could perform administration and asset management function, custody function should be ring-fenced and outsourced to the banking sector.



- 1) Consolidation of the supervision and creation of the single competent authority
- 2) Strong collaboration of existing supervisory authorities
- 3) Current approach of sectorial division of the supervision – special state institutions would be needed for non-state pension management companies

Strengths

Successful state social insurance system's reform
Relatively young population
Stable economic situation (low government debt and budget deficit)
Income from oil revenues
Resources from state oil resources

Weakness

Shadow economy
Highly dependent on oil industry
Low replacement rate of the insured labour pension part
The state pension system is not financially sustainable for the long term
Undeveloped financial instruments market, weak institutional investor base and slow private savings market

SWOT

Opportunities

Investment from oil fund – competence in transitional period
By introduction state funded pension scheme - accumulation of significant long term pension resources and the development of financial markets

Threats

Projected increase of the share of people in the age 65+
Deteriorating public finances (oil price and GDP)
Lack of trust to financial institutions and intermediaries
Decentralized financial and capital market supervision
Lack of reforms support from public authorities and institutions

Outputs of pension system reforms

Improve pension system long term sustainability

Achieve higher replacement rate in the retirement and help people save more for their retirement through safe and high quality complementary savings

Better access to supplementary schemes and their cost-effectiveness

Promote occupational pension schemes and support voluntary participation in pension savings

Development capital and long term savings markets and accumulation of national savings for stabilizing of national economy

Precondition for success of pension system reforms

Institutional framework – the most important

- A strong project team for implementation of reforms
- A common understanding of the objectives
- Cooperation with partners outside to SSPF
- Legislation base
- IT, relevant staff, creating accounting system

Financial framework

- Contribution rate
- State social budget financing vehicles / strengthening of tax collection and / oil-revenues support for transitional period
- Adequate financial market infrastructure, regulation and supervision
- Implementation year



THANK FOR YOUR ATTENTION!

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