



ANNEX 6

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

Funded component of insurance – pension system

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Gesellschaft für
Versicherungswissenschaft
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Goals of pension systems

To promote pension system financial stability in long term - diversification of demographical and economical risks

To increase replacement rate - protection of insured persons by saving more money for retirement

Why funded?

To reduce the long-term cost of pensions

Pension system less dependence from short term political decisions

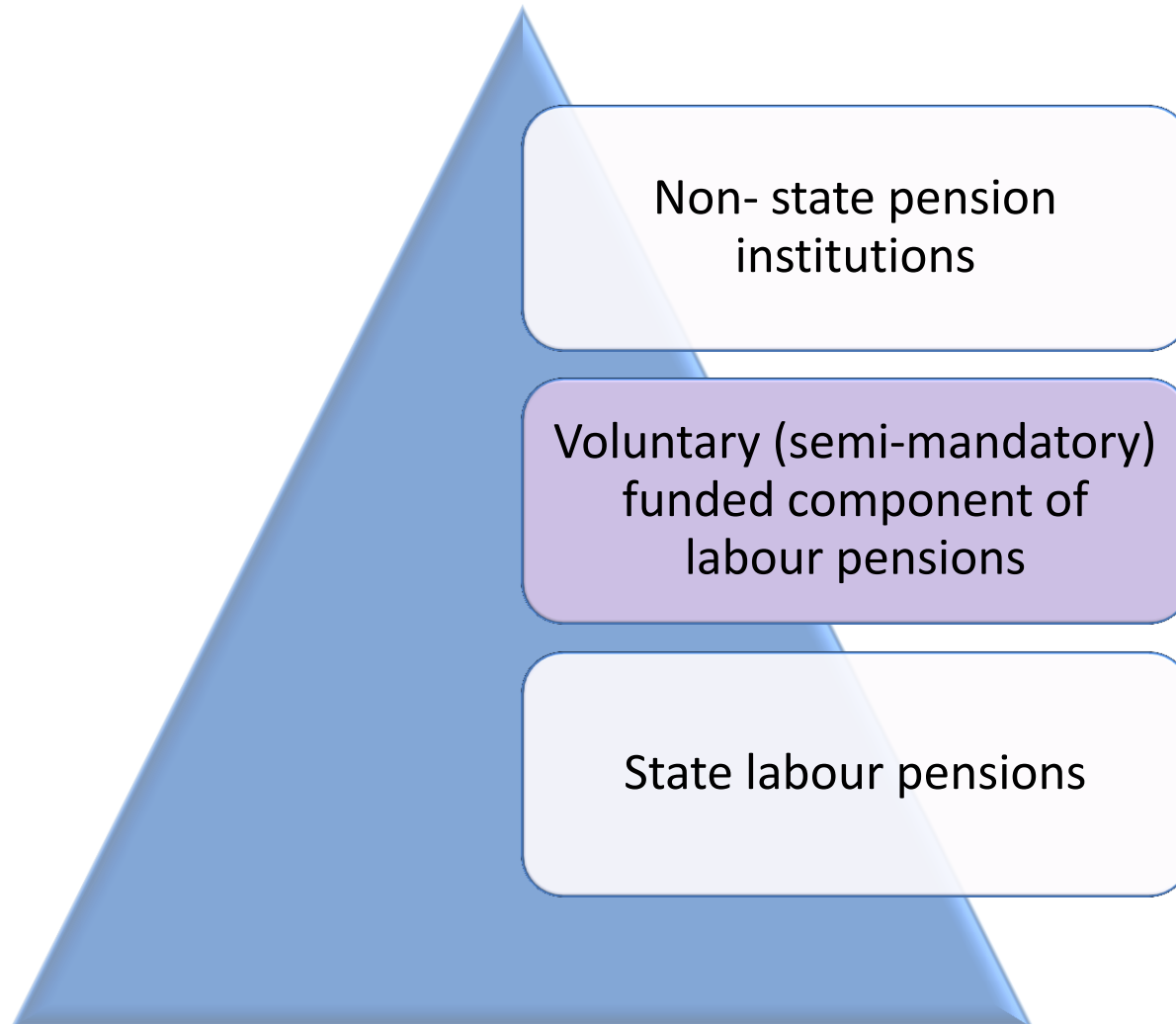
To provide higher replacement rate

To develop, stabilise capital market and to stimulate the growth of the economy

Reforms of pension provision system in the Republic of Azerbaijan in 2014-2020

5.7. Activation of voluntary funded component of labour pensions and development of non-state pension institutes. In order to achieve a reliable pension provision of people, it is intended to form mechanisms that allow provision **additional to the mandatory state social insurance**. It is considered reasonable to introduce voluntary social insurance on order to establish funded component in state pension provision system, as well as non-state pension institutions. To this end, it is intended to use a number of promotional means.

Proposal on Activation of voluntary component of labor pensions



Version 1 – mandatory funded component

- Mandatory
- Based on redistribution of contributions
- Transitional period

State funded pension contributions

1

	Year 1	Year 2	Year 3	Year 4
Unfunded part	12.5%	12.5%	12.5%	12.5%
Funded part	2%	2%	2%	2%

14.5%

2

	Year 1	Year 2	Year 3	Year 4
Unfunded part	18%	18%	18%	16%
Funded part	2%	2%	2%	4%

20%

3

	Year 1	Year 2	Year 3	Year 4
Unfunded part	23%	23%	23%	21%
Funded part	2%	2%	2%	4%

25%

Version 2 – Mandatory funded component with stimulation of voluntary contributions

- Mandatory + voluntary
- Based on **increasing of employee contributions by 2% points (from 3% to 5% mandatory)** and **redistribution of contributions** for voluntary participation (by 1% or 2% of state social contributions) as additional stimulus
- Inheritance or beneficiary option during savings and pay-out phase
- Transitional period

State funded pension contributions

Version 2

14.5%

- **12.5%** unfunded part (existing)
- **2%** funded part mandatory

15.5%

- **11.5%** unfunded part (12.5%-1%)
- **4%** = 2% + (1%+1%) funded part mandatory + (voluntary + redistributed)

16.5%

- **10.5%** unfunded part (12.5%-2%)
- **6%** = 2% + (2%+2%) funded part mandatory + (voluntary part+ redistributed)

Version 3 – Mandatory increase of contribution rate with stimulation of voluntary contributions

- Mandatory + voluntary
- Based on **increasing of employee contributions by 2% points (from 3% to 5% mandatory)** and **redistribution of contributions** for voluntary participation (by 1% or 2% of state social contributions) as additional stimulus
- Inheritance or beneficiary option during savings and pay-out phase
- Transitional period

State funded pension contributions Version 3

14.5%

- **14.5%** unfunded part (12.5% + 2% mandatory contributions increased by law)

15.5%

- **13.5%** unfunded part (14.5%-1%)
- **2%** = 1%+1% funded part voluntary + redistributed

16.5%

- **12.5%** unfunded part (14.5%-2%)
- **4%** = 2%+2% funded part voluntary part+ redistributed

State funded pension scheme versions

Employee contribution rate – inheritable/ add personal responsibility

1

2

State contribution rate	Increase of mandatory contributions employee part	Voluntary part	Redistributed part from state social contribution rate	Total contribution rate	Unfunded part	Funded part (FPS)
12.5%	2%	0%	0%	14.5%	12.5%	2%
11.5%	2%	1%	1%	15.5%	11.5%	4%
10.5%	2%	2%	2%	16.5%	10.5%	6%
12.5%	2%	0%	0%	14.5%	14.5%	0%
12.5%	2%	1%	1%	15.5%	13.5%	2%
12.5%	2%	2%	2%	16.5%	12.5%	4%

Version 1 – mandatory funded component



increase participation



decrease social insurance budget

Version 2 – Mandatory funded component with stimulation of voluntary contributions



voluntary participation with state support



decrease social insurance budget

Version 3 – Mandatory increase of contribution rate with stimulation of voluntary contributions



- voluntary participation with state support
- no influence to social insurance budget

Participants State funded pension scheme

Mandatory - 29 years old on act comes into force

Voluntary - 30 - 49 (included) years old on act comes into force

Non participants – 50 years old and older on act comes into force

Individual Accounts

Contribution into pension funds are made regulary

Waiting period for state contributions

Individuals choice of registered investment plan and provider

Limit when or how often participants can switch funds

Administration

State

- SSPF – accounting mandatory and voluntary state social contributions, transfers to Private Pension Management companies/ in transitional period keeps all individual accounts and provides information to members
- **Separate Supervision Institution on Private Pension Management companies and custodians / supervision financed by industry or by state**

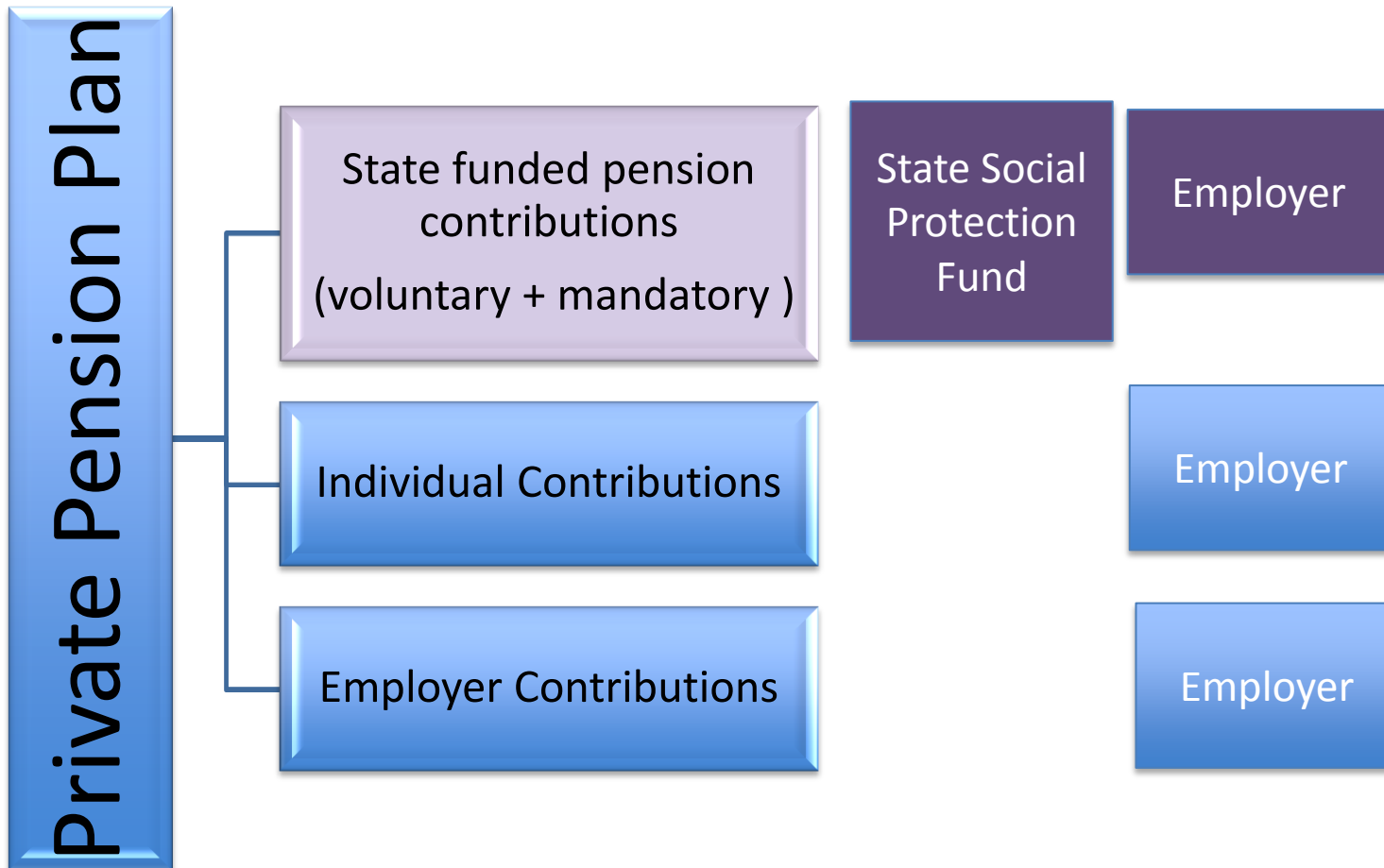
Private

- Private Pension Management companies – pension plans, marketing and distribution, fund accounting and reporting, NAV calculation, individual accounts, capital pay-out, asset management
- Life Insurance companies – annuities from funded pension capital
- Custodian – safe keeping of funded pension assets

Administrations costs

- State budget subsidies (in transitional period) – to cover SSPF expenses in case of voluntary participation in state funded pension scheme
- Fees to cover Private Pension Management and custodian services expenses – from contributions or from AuM by members of pension plans
- Set up for max fees – fee ceilings in law

Private Pension Management Company



Main challenges for building state funded pension scheme

Balance between social insurance contributions and expenditures for existing and future social insurance pensions and benefits

Improvement of contributions collection

Evaluation of adequacy of state social insurance contribution rate for pension insurance

Expected pension payment period (T) relation to life expectancy after retirement

Private savings, diverting current contributions rate to funded scheme



THANK FOR YOUR ATTENTION!

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