

DRAFT ACTION PLAN FOR THE IMPLEMENTATION OF THE FUNDED COMPONENT OF LABOUR PENSION

BY

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1 Context and Finding

In the course of the Twinning Project a *Law on Funded Part of the Labour Pensions* has been drafted as a legislative proposal for discussion and further elaboration. That proposal is based on the *Blueprint of establishment of the funded component and development of the legal framework in Azerbaijan*.

The entire approach is routed in the *Presidential Decree on Concept of Reform of Pension Provision in Azerbaijan* instructing the activation of the funded component of labour pensions.

When the legislation on the funded component will have been enacted eventually, the SSPF will be in charge as the principal authority to implement and administer the funded component.

In order to support SSPF in the preparation for the implementation a

preliminary Action Plan (henceforth AP) has been compiled.

2 Administrative implementation

A thorough AP should be comprehensive and detailed. It comprises objectives and tasks, it assigns responsibilities to particular units, it lists assumptions and risks. A timeline is foreseen as well and it should be detailed in the AP, when the legislative process is scheduled more clearly.

In the course of working off the AP, new tasks etc. will emerge. Therefore it should be well understood that AP are subject to a continuous process of up-dating.

The current draft of AP covers in particular the following fields of activity.

- Legal base

- Preparation of administrative procedures
- Adjustment of financial management procedures
- Preparation of investment decisions
- Adjustment of accounting procedures
- Preparation of risk management procedures
- Preparation for monitoring
- Preparation for reporting
- Preparation of counselling services and public awareness campaign

It should be noted that the section on risk management will be amended when an extended note on risk management becomes available

Table: Draft Action Plan

Wider Objectives and Tasks (1)	Steps and Activities Planned Outputs (4)	Assignment of Principal Responsibility (3)	Assumptions (A) Risks and Potential Obstacles (R) (4)	Timeline and Deadlines (5)	Additional Measures Follow up (6)	Remarks (7)
LEGISLATION						
Legal foundation of activities based on planned legislation	<p>Prepare analysis and interpretation of new legislation</p> <p>Prepare analysis of relation of legislation to other incumbent legislation: labour law, financial law, administrative law.</p> <p><u>Planned outputs:</u> Manual on the legal base of the funded component</p> <p>Communication of the legal analysis to other SSPF departments and to SSPF staff in general</p>	Legal department	Legislation and enactment can come on short notice	Start on the availability of draft laws, continue at the same time as legislation is emerging and voted. Finalize in due time after enactment.	<p>Consider relation to task of information to</p> <p>(1) General public (2) Employers (3) Potential clients</p>	Compile a list of unconventional cases and constellations

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ADMINISTRATION						
Prepare for registration of participants	Adjust forms for written application Draft letter of confirmation and acknowledgement	Individual Account department		Start on the availability of draft laws and finalize on enactment of the law.		Examples of the current Latvian practice will be provided during a planned workshop on administration
	Prepare explanatory leaflets to participants	Individual Account department in close cooperation with Legal department				
	Prepare IT system: hardware capacity, and software for processing registration	Individual Account department in close cooperation with IT department	Capacity constraint in the IT department Consider necessary time lead for programming and purchasing			
Prepare for notification to employers	Draft letter of confirmation and acknowledgement Prepare explanatory leaflets with general information on the rules governing the	SSPF / Individual Account department in close cooperation with Legal department				

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	operations of the funded component					
Prepare for the recording of payments into the second pillar personal account	Adjust Personal Accounts to allow data entries for voluntary component <ul style="list-style-type: none"> - contributions made - returns accrued - administrative fees deducted from capital - additional items 	Individual account department IT department	(R): No budgetary support to cover the set-up cost is granted.	The size and allocation of administrative cost should be clear from the beginning to avoid disappointment on part of the plan participants	Regarding the <u>deduction of administrative fees</u> during the initial phase of the scheme, the proposed law requests reimbursement of set-up cost from the general budget. In that case no fees ought to be deducted during the introductory phase. In case the law does not satisfy that request, a method for the allocation of set-up cost has to be defined. It is recommended to then to distribute expected set-up cost jointly over the entire introductory phase.	
	Establish a procedure to separate payments to mandatory part from	Financial department	(R): If no comprehensive IT solution can be			

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	payments to voluntary funded component	Individual account department	established, this problem will impose a huge workload on the staff concerned.			
	Adjust structure of and enlarge staff in line with growing participation in the fully funded component of labour pensions Identify training needs	Individual account department Staff department	(A): Sufficiently qualified personnel can be recruited Budgetary provisions for additional staff are available (R): Sufficient lead time for specific training is not available			
Prepare for default investment while payments wait for instructions (Design of Default Fund)						Implementation of the appropriate investment strategy is elaborated below.
Default fund during introductory period	Define default fund to match the retirement income objectives of the funded component	Individual account department in cooperation with Legal department				<i>Explanation:</i> In the introductory phase of the funded component, contributory payments are collected by SSPF, however, the funds are not invested in the financial market in a broad sense.

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						Instead those funds are invested in a save financial instrument e.g. bank deposits or instruments issued by the government. The rationale for such a concept is to keep financial risk and turmoil out of the pension scheme as long as portfolios are small.
Default fund after introductory period	Define default fund to match the retirement income objectives of the funded component	Financial department		To be put on hold until the end of the introductory phase comes closer		<p>The default fund to be established after the introductory phase should take into account the long-term horizon of pension saving, and therefore provide for more developed portfolios. It should include two options: One is for those who want to invest only with minimum or no risk. Such a default fund would invest in real (i.e. with implicit or explicit inflation protection) government bonds.</p> <p>The second option for a default fund should be designed according to life-cycle smoothing principles. This means assets are moved from riskier – and more profitable – investments at earlier ages to index bond allocations at later ages, closer to retirement. Within</p>

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						the spectrum of life-cycle fund designs the portfolio of a default fund should probably be towards the cautious end.
ACCOUNTING						
Adjust capacity, structure and performance of the accounting department to the required standards of a fully funded component	Review current structures and processes regarding accounting standards, IT software to run accounts in line with standards, appropriate It software, appropriate IT hardware against appropriate benchmarks	Accounting department in cooperation with financial department, legal department and			Address particular concern on methods to valuate financial instruments. Consider the attachment of actuarial principles to the valuation of financial instruments in order to avoid extreme volatility	Benchmark for accounting standards could be - IPSAS: International Public Sector Accounting Standards - IFRS: International Financial Reporting Standards (for private sector financial instruments)
	Identify necessary and appropriate adjustments to take domestic features into account.					
FINANCIAL MANAGEMENT						
Adjust capacity,	Assess financial	Financial				Default options have to be defined

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structure and performance of the financial department to the required standards of a fully funded component	planning instruments regarding strategic financial planning and liquidity management	department In cooperation with accounting department and legal department				for the time between payment and the end of the quarter and for case were no consumer instructions exists
Prepare for dealing with asset manager	Prepare framework agreement on investment of funds Consider international examples of framework agreements with asset managers	Legal department Financial department			Get professional legal advice on this	Examples of the Netherlands, the United Kingdom, Latvia, etc. could be considered.
	Recruit staff to deal with asset manager on a day to day basis to implement the investment strategy.	Financial department				
Prepare for investment decisions	Establish an Investment Committee to decide on the guidelines and strategy for investment of the fund (in the default fund)	SSPF Management / Financial Department				
Prepare for investment planning	Recruit new staff to prepare the investment	Financial department	(A): New staff for investment			The investment plan should instruct the asset manager

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	strategy and the investment plan Train current staff in investment planning (training from outside)		planning could be hired from the market. New staff should include senior professionals with experience from the private sector			regarding permitted asset classes, quantitative investment limits, limits to risk exposure benchmarks, ...
Prepare for pay-out of the accrued capital at retirement	Establish liquidity management to gear processes of dis-investment				Align liquidity management with tactical investment plans	
RISK MANAGEMENT						A note to outline Risk Management Issues is under preparation
General Issues	Develop a proper understanding of the risks related to dealing with risks in the entire organization <i>See column Remarks</i> Establish a risk management unit at the level of the board of directors	Management Legal department		The responsibilities should be allocated to separate departments and personnel to reduce potential conflict of interest		Risk management is a cross sectional tasks. It has to deal with regulatory requirements, market requirements and internal stipulations. The purpose is to identify and monitor potential risks, mitigate and hedge those risks. Risk management must be seen as a forward looking process
Operational risks	Identify operational	RMU				

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	risks related to IT processes, e. g. system failure, software problems, cyber crime, etc., Establish protection where possible, Draw up contingency plans.	IT Department				
	Identify operational risks related to fluctuations in the workload, e.g. meeting deadlines regarding response time, transfer of funds, pay-out of funds, etc. Assess minimum number of staff to deal with unexpected peaks in new participation Establish contingency plan for staff flexibility policy in case of peak loads. Define training needs accordingly.	RMU Individual Account Department Staff Department				

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Financial risk						
Investment risks	Establish model to monitor investment risk:	RMU Financial department				
Legal risks		RMU Legal department				The model for risk monitoring should include: Economic and financial environment Measurement of risk exposure
Auditing and control	Establish an internal auditing scheme				Consider the use of external auditing where appropriate	
Prepare for dealing with supervisory authority on matters of funded pensions	Form a working party together with the Supervisory Authority Establish benchmarks and procedures for supervision	Legal department / Financial department / Individual Account department / IT Department				
	Prepare for drafting regular reports on the fully funded component: define a potential table of contents		Allocate task for drawing up regular reports	Train staff on reporting		

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MONITORING OF THE FUNDED COMPONENT						
	Establish a monitoring programme to assess the financial performance of the funded component and the impact on the retirement income of various groups of the population	Forecasting department				
REPORTING						
Preparation of mandatory annual reports	Assign task to staff members	Legal department in close cooperation with forecasting department, individual account department and financial department				
PUBLIC AWARENESS						

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AND COUNSELLING SERVICES						
Prepare for public awareness campaign and ongoing publication of information regarding the funded component	Draft written material (booklets, leaflets, etc.)to explain the funded component Expand SSPF's Website to inform on the funded component.	Legal department Public relation department				
Counselling services	Prepare general information on the rules governing the operations of the funded component and major changes Train staff on the specific features of voluntary participation, e.g. implications of participation and non-participation Implication of continuous and interrupted contributing	Legal department Public relations department				

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