ANNEX 12

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

Closing Conference

Wednesday, the 28th of October, 2015

MINISTRY OF WELFARE OF THE REPUBLIC OF LATVIA

Gesellschaft für Versicherungswissenschaft und -gestaltung e.V.

"Framework of pension system including Republic of Azerbaijan"

von

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Introduction

- Multi-level pension systems
  - Different approaches
  - Different legal requirements

- Overview about existing approaches
- Aims and requirements

Existing Approaches

- Depending on the size / replacement rate of the basic scheme
- Means:
  - the lower the replacement rate of the basic scheme
    - the more important are second and third level
    - the more the state is eager to promote it
    - May lead to mandatory second tier
  - Example: United Kingdom (Great Britain)
  - Example: To a certain extent the Netherlands

Existing Approaches

- In case of high replacement rates of the basic system
  - ✓ Second and third level is often under-developed
- Examples are Southern European countries

Existing Approaches

- A country might have to limit the scope of its basic system
  - ✓ Supplementing (in part replacing) it by a mandatory or voluntary supplementary system
- Examples: Germany (Riester) and Sweden

- A country might want to diversify the financing of its system
  - ✓ From PAYG to a combination of funding and PAYG

Existing Approaches

- The different tiers / layers
- Traditionally three tiers / layers
- May Mean
  - ✓ Public system
  - ✓ Occupational pension
  - ✓ Individual Savings / Life Insurance
- Example: Germany

- May also mean
  - ✓ Basic public system (not earnings-related)
  - ✓ Earnings-related second – public-system
  - ✓ Individual savings / Life Insurance
- Examples: Canada, Switzerland

Existing Approaches

- Additional second tier
- Based primarily on employer
  - ✓ Defined contribution (DC)
  - ✓ Defined benefit (DB)
- Core questions:
  - ✓ Who should bear what risk?
    - DC plans and investment risk
    - in DB plans less likely
  - ✓ Lump sum or annuity?
    - Longevity Risk?

Existing Approaches

- Own initiative
  - Incentives?
    - tax deductibility
    - subsidies
- Eaxmple: Germany (Riester)
  - Risks?
    - Choice of product
  - Requirements
    - Limited to use in old age?

Existing Approaches

- Mandatory vs. voluntary
  - Advantages and Disadvantages
    - ✓ mandatory only good for limited amount
    - ✓ mandatory full coverage
    - ✓ Voluntary needs incentives (costs for budget)
    - ✓ Mandatory – how to enforce?
- Examples:
  - Netherlands quasi-mandatory by collective agreements
  - Canada / Switzerland – mandatory according to the law
  - Germany voluntary – limited coverage

Existing Approaches

- Public vs. Private Solution
  - In case of public solution – state is in charge and may have to give guarantess
  - In case of private solution – control on investment – protection against insolvency
  - In both cases: Institutions to manage the system
    - In case of private solution
      - via for-profit insurance companies
      - via non-profit institutions

Existing Approaches

- Contributions /Financing
  - Only employer
    - Example:
      Germany on occupational pension (changing)
  - Only employees
  - Combination of both

Azerbaijan Solution

- ❖ Will now be a three-tier system
- ➢ With the second pillar consisting of two elements
- ✓ social insurance
- ✓ voluntary funded component
- ➢ With the third pillar consisting of a voluntary funded system in addition

Azerbaijan Solution

- ❖ funded component in the state system is to be found in a number of countries
  - ➢ Constructed in different ways
  - ➢ Mandatory as well as voluntary
    - ✓ In the latter case issue of incentives
  - ➢ Usually not state run – but for transition
- ❖ Voluntary Third Pillar more or less linked to employment
  - ➢ also here issue of incentives

Azerbaijan Solution

- The new system which is proposed is based on international experiences and follows those models
- But with a special Azerbaijan component and solution
- It is important not to take one system as blueprint but find a tailored solution

THANK FOR YOUR ATTENTION!

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