



ANNEX 5

Possible Solutions for Development of Multi- level Pension System in the Republic of Azerbaijan

by
Prof. Dr. Heinz-Dietrich
Steinmeyer



- 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 underdeveloped
 - 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
- Example: 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



Existing Approaches

■ Benefits / Risks covered

- DB vs. DC
- Old Age and (?) Survivors, Invalidity
- Lump Sum or Annuity?