October 12th, 2017

AIDE MEMOIRE

GEORGIA

POLICY BASED LOAN

PRIVATE SECTOR COMPETITIVENESS

Technical Assistance on pension reform

Mission- September 11-14th, 2017

I. MISSIONS' CONTEXT AND OBJECTIVES

After initial discussions held during the first quarter of 2017, the Ministry of Finance of Georgia (MoF) officially requested the French Development Agency (AFD) in March 2017 to consider the possibility to co-finance the ongoing Development Policy Operation (DPO) of the World Bank (WB) for an amount of 60M€. Following exchange with WB team, AFD agreed in principle to cooperate with the WB on the *Private Sector Competitiveness* DPO, tranche 2 (DPO 2). Given AFD and more globally French expertise in the field of pension reform and management, AFD has decided to focus more especially the policy dialogue on the implementation of the forthcoming reform of the pension system in Georgia, which is one of the core actions to be set up under the DPO 2. AFD is also considering extending a 500K€ grant in addition to the policy based loan to finance technical assistance and capacity building dedicated to this reform.

AFD conducted a first appraisal mission in May 2017 together with WB team in charge of the DPO2, in order to assess the implementation of the measures contained in the policy matrix agreed with the WB under the DPO 2 and to identify the components of the technical assistance to be funded by AFD. The WB Board approved the DPO2 on July 26th 2017, validating the implementation of all measures in the policy matrix.

From September 11th to 14th 2017, AFD conducted a mission aiming at:

i. Defining the technical assistance needs in collaboration with the key stakeholders: Ministry of Finance, Ministry of Economy and Sustainable Development and the National Bank of Georgia, international donors involved in the reform (WB, Asian Development Bank and USAID) ;

ii. Discussing the terms and conditions of the credit facility agreement (CFA) to be signed between AFD and the Government of Georgia ;

iii. Starting discussions with the Government of Georgia regarding a new policy loan.

AFD team was composed of Mr. Nicolas Le Guen and Mrs. Aurore Lambert (Project Managers), Mr. Sébastien Glais (senior legal counsel), Mr. Maxime Lebovics (Financial support) all based in Paris, Mrs. Gaelle Assayag, Head of AFD representative office for the South Caucasus and Mr. Hugo Bérard, Project officer (based in Tbilisi). AFD invited Mr. Andrei Tretyak, Head of Expertise France Social Protection Unit to join the mission as Expertise France is the French public agency in charge of implementing French expertise and technical assistance in foreign countries. AFD mission was held simultaneously with WB mission on pension reform.

The Mission met with the Ministry of Finance (MoF), the Ministry of Economy and Sustainable Development (MoESD), the Ministry of Labor, Health and Social Affairs (MOLHSA), the National Bank of Georgia (NBG), the World Bank, the Asian Development Bank (ADB), USAID, the Delegation of the European Union in Georgia (EU), UNICEF and the French Embassy. The list of persons met by the mission is attached in the Annex 1.

AFD mission wishes to express its sincere thanks to all the persons met and particularly the Georgian authorities for their kind welcome, hospitality and availability, and for the high quality and operational value of the discussions.

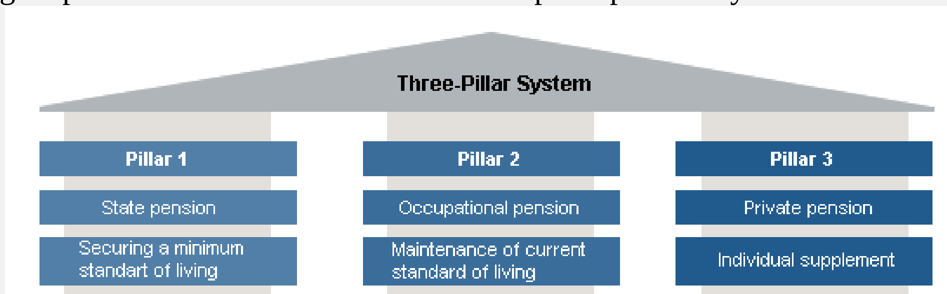
This Aide-Memoire summarizes the main outcomes of the mission.

II. PENSION REFORM CONTEXT AND CALENDAR

MAIN FEATURES OF THE GEORGIAN PENSION REFORM

The current Georgian pension reform aims to address three main issues :
- Providing a minimum and fair income for elderly people ;
- Ensuring the financial sustainability of fiscal budget and
- Coping with the demographic shift in the population.

The Georgian pension reform is based on the three pillar pension system.



The first two pillars are the main focuses of the Georgian pension reform :
- **Pillar 1 - A universal social pension** available to all Georgian citizens who have reached specified retirement age is financed since 2004 through the general budget revenues and serves as a strong poverty alleviation mechanism for the elderly people. The Ministry of Labor, Health and Social Affairs (MoLHSA) is responsible for allocating this state pension. An indexation mechanism (inflation, GDP, etc.) is under discussion but is not included in the current law draft ;
- **Pillar 2 - A private pension system** will be introduced by the pension reform. Contribution rates will be shared between the employer, the employee and the state. The proposed private pension scheme lays out a 2% + 2% + 2% system for legally employed workers. To encourage the savings, the government will give strong financial and tax incentives: contributions, investment returns and pay-outs will be tax exempt. The funds will be administered by a non-profit pension fund set up by the Parliament.

A Pension Reform Unit (PRU) has been created under the Ministry of Economy and Sustainable Development (MoESD) to design the pension reform strategy.

The mission allowed clarifying the context and the content of the ongoing pension reform along with the current situation and the next steps for the approval of the law and the implementation of the reform:

Expected calendar of the pension reform implementation 2017-2018

2017	**2018**
September: Final draft of the law **October:** Public Consultation **December:** Approval by the Parliament	**1st Quarter :** Pension Agency implementation / first employees hired **Communication campaign** **3rd Quarter :** first contribution collection

1. A **new draft of the law** will be finalized by the end of September. The drafting of the law was delayed to allow consultations with the employers' representatives and with the National Bank of Georgia regarding its future supervision role. This new draft law

should be submitted for public consultation by the end of September for one-month period and then be introduced to Parliament in November or December for final approval ;

2. The detailed project **roadmap** for the operationalization of the Pension Agency is currently being elaborated with the support of the Asian Development Bank (ADB) technical assistance. This roadmap includes around six or seven different components covering HR organization, governance, developing operational manual and protocols, etc. The first part of the roadmap describing the main features of the Pension Agency (including number of staff for example) has already been submitted to the MoESD and circulated for comments.

3. The **first contribution** collection is planned for the **third quarter of 2018**.

The pension reform is a long process and key issues are still under discussion among the stakeholders both on the policy design and on the operational set-up:

1. Policy Design

(i) As of September 2017, the **Pension Agency regulatory body and governance** could be organized as followed :

1) The National Bank of Georgia (NBG) which supervises all the financial sector will be the regulatory authority for the future Pension Agency ;
2) The Pension Agency will have a Supervisory Board composed by the following ministries: MoESD, MOLHSA and MoF.
3) The Pension Agency should have an independent Investment Board composed by five to six industry professionals. The Investment board should oversee the investment activities and most of its members are expected to be foreign professionals.

(ii) **The investment policy.** The investment policy should *protect participants from excessive investment risks*, while on the other hand allowing investment allocations to be designed in such a way that it allows the system to *generate sufficient long-term returns* to ensure fair pensions to the contributors. Investment policy is set up at different levels:

1) The draft law already includes allocation principles mainly on types of asset classes;
2) The NBG will set up limits (investment caps, diversification limits) notably on foreign investment at least for the first five years ;

2. Operational design / Contribution collection process

Contribution collection system has to be further defined by the Pension Reform Unit (PRU) composed by both MoF and MoESD. While the Revenue Service was primarily identified as the entity responsible for the contribution collection, the MoF has decided to set up a collection mechanism through commercial banks. The contributions collection (employees and employers part) would be done by the banks when the salaries are paid by bank wire. The MoF estimates that wires represent around 92% of paid salaries against 8% in cash. Around 20 commercial banks will need to participate in this process. Some of them are still reluctant but the mission was told that most of them agree to do it without charging banking fees. The employers, when sending the salary transfer, should tick a box in the bank form to inform they agree on the contribution.

Many questions are left open on this process: how the pension fund will be able to enforce the contribution payment if it is only based on employer's declarations? How will the pension fund be able to make sure the employer paid 102% of the salary to include its 2% of the contribution? How the pension fund will be able to reconcile the money flowing in from the bank and the individual records of the employees? How will the employers handle the employees that have opted out when paying the salaries? Can that system create an incentive for employers to pay part or the whole salary in cash? How to ensure the bank will not charge a fee to process those payments?

The success of the pension reform is partly subject to the implementation of a transparent and enforceable collection system. Therefore, the questions raised above have to be addressed while designing the IT collection system. In this regard, technical assistance could be mobilized in the beginning of 2018 to support the PRU and AFD has expressed its availability to discuss alternatives models.

III. TECHNICAL ASSISTANCE

1. Technical Assistance provided by active donors

During the mission, AFD team met with the different donors involved in providing technical assistance (TA) for the pension reform to discuss updated plans for the coming years in order to avoid redundancy and ensure complementarity. Main findings are summarized in the below table:

Summary of donors main areas of technical assistance for the pension reform 2017/2018 based on updated contribution from September 2017 mission

	World Bank	**ADB**	**USAID**
	2017- 2020 : 400K USD TA over 3 years on pension reforms	*2018 TA: 300K USD*	*To be determined*
Legal	Assistance with drafting legislation to support the pension reform strategy	Support for drafting the law with two international and one local lawyers ;	Support for discussions with MPs about the final draft / elaboration of simplified policy papers on the reform ;
Investment Policy	For the pension Regulatory/Supervisory Authority : -Capacity building; -Assistance with drafting/implementing regulations ;	Bring the international perspective on investment fund management; Support the preparation of the overall investment policy guidelines and investment options for pension fund assets ; Support for the selection of 3 key investment staffs ;	
Communication			Support the communication campaign Participation in the outreach system (TV adds, website, etc.).
IT		Support development of IT	

		systems and request for proposals (when needed); detailed business processes, including the determination of roles and responsibilities for involved agencies;	
Operational set-up		Propose a draft action plan for the creation of the Pension Fund: processes required for the implementation, accounting, internal controls, complaint and grievance response system, etc.	

2. AFD Technical Assistance first proposal elements

AFD team together with Expertise France support discussed with the Ministries in charge and the National Bank of Georgia (NBG) the needs for technical assistance and the most relevant "format" and calendar.

AFD confirms that grant resources (500 k€) will be mobilized to provide technical assistance and contribute to build capacities of the Pension Agency. A specific grant facility agreement (separate from the credit facility agreement) will have to be concluded between AFD and the MoF once the components of the TA have been discussed and commonly agreed with all relevant Georgian stakeholders.

AFD TA should mainly be used for technical assistance and not for investment in any kind of assets (hardware, building, furniture). AFD TA should be a mix of French expertise and local or other international experts. Activities could include documents drafting, capacity building sessions, advisory services, study tours, training based in Georgia or in France, etc.

a. Organization of the TA

Given the uncertainty on the calendar and the fact that TA needs will certainly emerge during the implementation of the Pension reform, AFD proposal aims at giving a **broad framework that is deemed to evolve.** This should ensure certain flexibility in the implementation of the TA in order to adapt the proposed TA to the evolving needs.

The **timeframe of the TA** will depend on the pace of the reform operationalization[1]. Based on the calendar discussed with the authorities, the TA program could start **from January 2018 for a two-year period.**

AFD proposes to have a technical assistance team coordinated by a **team leader specialized in pensions** in charge of the animation of a continuous dialogue with the Pension Agency and the ministries on the TA needs. During the first phase of implementation, the team leader will spend at least a week in Georgia every six weeks. The team leader will be in charge of identifying the relevant experts depending on the needs expressed mainly in the fields listed below.

[1] Specific operational TA support should be only provided once the Pension Agency staff has been hired to ensure ownership and capacity building.

As a bilateral donor, AFD added-value resides in its ability to **mobilize French public and private sector expertise to provide peer-to-peer technical assistance**. If needed, AFD can also provide local or international expertise on the specific areas identified.

To introduce AFD TA and ensure a shared understanding by all the stakeholders of the needs as well as the expertise that can be mobilized through AFD TA, AFD proposes to hold an inception and launching event at the beginning of 2018.

This event will have a double objective:

- Discuss with all the stakeholders the proposed content and time schedule of the TA to ensure those are in line with the current situation of pension reform implementation and needs;
- Present and/or share experience from France and Georgia mainly but also from other countries such as Morocco, Lithuania, Croatia, Algeria, on the overall organization of pension schemes, the main parameters (coverage, conditions for participation, collection of contribution) but also on specific features of interest: governance, information system, investment policies, organizational structure of pension authorities, capacity building programs, pension schemes supervision, etc.

b. Main focus of AFD TA

Proposals from AFD last aide-mémoire were discussed with the Ministries in charge during the September mission. Main areas of interest seem to be the following:

Operational set-up of the new Pension Agency

<u>Objective</u>: Provide continuous assistance to the operationalization of the Pension Agency during the first steps of the reform implementation

This activity will be implemented throughout all duration of the Project. Even if the main features of the reform are already settled in the Pension Law, the continuous support of the TA team could be helpful to provide suggestions aimed at fine-tuning the processes and procedures for the pension system (mechanisms of contribution collection, development of standard forms, individual records handling, payment mechanisms, etc.)

One of the main tasks of this activity is to provide *suggestions and recommendations on administrative and operational organization of the future Pension Agency*, job description and workflows. Furthermore, special attention should be paid to building of internal capacities in terms of organisation of forecasting (including actuarial calculations), budgetary processes, monitoring & evaluation and information system. The staffs will be hired at the beginning of the 2018. The TA team can support the Georgian authorities in defining selection procedures based on the approved administrative structure of the future Pension Agency.

Close cooperation with the TA activities funded by ADB "one-year consultant contract to draft a roadmap for the operational set-up" is necessary. The roadmap for the operational set-up of the future Pension Agency is being drafted by ADB consultant and should be finalized by October 2017. This roadmap could be reviewed by AFD TA team at the beginning of the Project (Q1 2018) in order to check the compliance with the final version of the Pension Law as well as to provide the first suggestions from the point of view of experts experienced in running pension schemes.

During the implementation of this activity, the experience of different countries (such as Morocco, Lithuania, Croatia, or Algeria) could be presented. Experience of other countries can be considered upon agreement with the Project beneficiary.

Regarding the implementation and reinforcement of the communication strategy, the French National Pension Fund has recently developed various web based tools for contributors to simulate their future pension levels, retirement age, etc. In this regard this experience can be used in order to assist the Georgian authorities in the implementation of their communication strategy by developing concrete communication tools.

This component of the TA should also include a strong focus on Monitoring Information System (MIS) in order to give the IT team support to identify future challenges for the IT system to be able to handle all the aspects all the pension scheme from contribution collection to investment management including reporting needs, with an emphasis on the issue of individual records.

Some outputs of this TA component could be:

- Recommendations based on the roadmap currently under preparation ;
- Recommendations for the organisational structure, job description and workflow;
- Assistance in selection of staffs for the new agency ;
- Best practices sharing for pension schemes organization in different countries ;
- Recommendations on implementation and reinforcement of the communication strategy

Workshops and video-conference could be organized if necessary during the implementation of this TA component.

Capacity building

Objective: Evaluate specific needs in terms of training for the staff of the new Pension Agency and carry out first trainings in order to build the capacities of the new team

At this stage, it is foreseen to hire 25-30 staffs at the beginning of 2018. Based on the approved administrative structure of the new Pension Agency and the selection of staffs, the TA team will assess the training needs to ensure that the training programme meets the needs of the participants and forms a coherent whole. Based on this assessment a comprehensive training program will be developed by the TA team and proposed to the staffs of the new Pension Agency. The staffs of other public Georgian bodies could be included in these training activities in order to reinforce the synergies between the different agencies/entities dealing with pension reform in Georgia.

France has an experience in organizing continuous education for staff of social protection institutions. The National Institute for Social Security (EN3S) trains future directors of social protection agencies and management staffs. The TA team can present the curricula for pension schemes management and adapt it to Georgian specificities.

After the implementation of training sessions, the TA team will gather all training materials under a training handbook which can be used after the end of the Project for continuous education purposes.

Output:

- Training programme including training needs assessment
- Trainings workshops for the staffs of Pension Agency and other stakeholders

Investment policy

Objective: Support the definition of the investment policy for the Pension Agency

This activity will provide specific technical assistance for the definition of the investment policy in the new Pension Agency. The future investment board will include 5 independent members (experienced persons, probably foreigners). This board will be in charge of defining the investment policy strategy and then make investment decisions. If needed, the TA could assist the Pension Agency in the selection procedure of qualified persons to be members of the investment board. Specific support could be given to the National Bank of Georgia as the supervision body as well.

This component will be coordinated with WB and ADB TA.

Output:
- Recommendations on investment policy for the Pension Agency
- Assistance in selection of qualified staffs.

A study tour to France for 7 to 10 Georgian officials dealing with pension reform and management

Objective: Share the French experience in pension schemes

A Study Visit for Georgian officials dealing with pension reform and management will be organized with the aim to share experience and best practices as well as to create personal and institutional links between Georgia and France. The delegation will meet with main first, second and third pillar organizations such as the National Fund for Elderly, the complementary pension funds and the different organizations (insurance and pension funds) running supplementary pension. Other meetings will be held with supervisory bodies: Committee of pension orientation, the financial market authority, etc. or with control institutions. Other meetings could be organized depending on the participants or upon specific request. The study visit shall last for 5 days and the list of participants will be agreed with the beneficiary.

3. Coordination meetings

Considering the number of donors mobilizing TA to support the pension reform, regular roundtables of donors under the leadership of Georgian authorities would be helpful to have a shared knowledge of the TA needs expressed by the Pension Agency and avoid overlap.

IV. NEXT STEPS

- According to AFD internal process, the 60M€ policy loan to support private sector competitiveness has been approved by AFD board on September 27th 2017.

- AFD and the GoG will sign the credit facility agreement by the end of October 2017 in order to disburse (through a single drawdown) by the end of 2017 or before the end of January 2018 at the latest;

- Regarding the TA components, AFD would be grateful to the Georgian authorities for providing official feedback and any comments/questions or suggestion on the preliminary proposals made in this aide-mémoire.

- The grant facility agreement for technical assistance will be signed after approval by AFD dedicated board expected to be held by the end of 2017. TA might start early 2018.

V. FUTURE COOPERATION BETWEEN AFD AND GEORGIA THROUGH POLICY BASED LOAN

AFD expressed its interest to pursue its partnership with Georgia by developing **a multi-annual funding program (Policy based loan)** aiming at including AFD's interventions as part of a long-term policy dialogue.

In July 2017, the Georgian Government presented a matrix to diplomatic representatives and donors as part of the Thematic Coordination Group on **Social Welfare**, highlighting a series of objectives for which the following topics could be subject to a new policy loan:

- The development of social support and solidarity systems targeting social support, disability and child protection;
- Ensuring an affordable and quality healthcare and the promotion of healthy lifestyles through an effective and efficient universal healthcare system, a straightened postgraduate medical education system and improved mental health services;
- The optimization of the resources allocated to IDPs.

Support to the pension reform (indexation of the universal pension and the establishment of the Pension Agency) could also be monitored under this new policy loan.

The project team of the Health department of AFD met with the Ministry of Health, Labor and Social Affairs which presented the challenges raised by the reforms planned by the Government according to the Social Welfare matrix.

AFD is willing to provide support to the Georgian authorities to implement the reforms presented above as part of the **multi-annual program covering a 3 year-period (2018-2020)**.

Amounts will be determined according to the needs expressed by the Ministry of Finance and other AFD sectoral commitments in Georgia.

AFD is considering the possible **mobilization of a new grant** in addition to a new policy based loan, to support the implementation of reforms and actions developed in the social welfare matrix under the form of technical assistance.

If this approach is accepted by the Georgian authorities, AFD intends to mobilize the necessary expertise in the **first quarter of 2018** to launch discussions on the policy matrix. Considering WB expertise and the fruitful partnership initiated within the framework of the DPO2, AFD is also willing to involve the **World Bank** to support the development of the matrix (targets and indicators). As a key player in the social protection sector, **UNICEF** could also be involved in this activity by working on social services mapping, impact assessment of social transfers and child protection actions.

AFD would be grateful to the Georgian authorities for providing their feedback on this proposal and remains at the disposal of the MoF and MoLHSA for further exchanges on this topic.

ANNEX 1: List of Persons met by AFD Mission

Ministry of Labor, Social Affairs and Health
Nutsi Odisharia, Head of Social Protection Department
Ketevan Goginashvili, head of Health Policy Department
Ministry of Finance
Nikoloz Gagua, Deputy Minister
Mzia Giorgobiani, Deputy Head of Public Debt and External Financing Department
Tamar Avalishvili, Senior-SpecialistGiorgi Mamatelashvili, IT manager

National Bank of Georgia
Archil Mestvirishvili, Deputy Governor
Lasha Jugheli, Advisor to the Governor
Robert H. Singletary, Board member

Ministry of Economy and Sustainable Development of Georgia
Nino Javakhadze, Deputy Minister
Beka Liluashvili, Head of Economic Reforms Division
Giorgi Chichinadze, Acting head of Capital Market Development and Pension Reform Department

Delegation of the European Union to Georgia
Monika Csaki, Counsellor –Deputy Head of Political, Pres and Information Section
Nika Kochishvili, Programme Officer Education, Science, Employment, Health, Institution Building
Nino Samvelidze, Programme Officer Education, Science, Employment, Health, Institution Building

World Bank
Anita Schwartz, Social Protection and Labor Global Practice, Washington DC
Lire Ersado, Program Leader, Human Development

USAID (Growing for Growth in Georgia)
Natalia Beruashvili, Chief of party
Nino Chokheli, Deputy Chief of party

Asian Development Bank
Mariam Rusishvili, Project coordinator
Michiel Van der Auwera, Unit Head, Project Administration