

**SUPPORT TO THE LEGAL FRAMEWORK OF THE NEW PENSION SYSTEM
AND CREATION OF THE PENSION SUPERINTENDENCY IN NICARAGUA**

(TC-99-02-01-0)

EXECUTIVE SUMMARY

BENEFICIARIES:	Pension Reform Technical Commission (CREPEN) Pension Superintendency (SUPEN)		
EXECUTING AGENCY:	Technical Secretariat of the Presidency of the Republic		
PROGRAM COST AND FINANCING:	MIF Grant –Facility I:	US\$1.200.000 (60%)	
	Local Counterpart:	US\$ 800.000 (40%)	
	Total:	US\$2.000.000 (100%)	
IMPLEMENTATION TIMETABLE:	Period of Execution:	36 months	
	Period of Disbursement:	40 months	
SPECIFIC OBJECTIVES:	The program will assist the Government of Nicaragua in the preparation of the two crucial steps necessary before workers start joining the new pension system currently being prepared: (i) the establishment of an adequate legal and regulatory framework (ii) the design and implementation of an appropriate supervisory oversight of the new pension system. These objectives will be pursued in two separate and sequential steps corresponding to Part A and Part B of this project.		
DESCRIPTION:	Program components include: Part A (i) Preparation of a draft legal framework for the new pension system to be submitted to the National Assembly and preparation of regulation necessary for its implementation, including prudential investment rules for pension funds, (ii) Training to legislators, aimed at increasing their awareness of the main problems of the current pension system and alternatives of reform. Part B: (iii) Support to the GON for the formulation and execution of an implementation strategy for the reform, (iv) Establishment of the pension Superintendency, including design and implementation of legal, institutional, administrative, financial and technical aspects, (v) Information systems for the Superintendency, including internal system and online connection to the supervised entities, (vi) Training program for the personnel of the Superintendency and for other key players in the reform.		

ENVIRONMENTAL IMPACT:	The Environmental and Social Committee approved this operation in its session on May 3, 1999.
RISKS:	This project faces two main risks: (i) Difficulty in approving the reform. The approval process in the National Assembly may prove to be lengthy given the political sensibility of social security. Measures to mitigate this risk are envisaged (par. 6.2); (ii) Successful implementation of the reform. Given the complexity of the reform and the incipient financial sector in Nicaragua, there is a risk that full implementation may be difficult to achieve in a short time. Both the Government and the Bank are aware of this risk and have already taken steps in order to mitigate it (par. 6.3).
RETROACTIVE RECOGNITION OF COUNTERPART:	Activities under Part A are already in preparation. It is proposed that the Bank may recognize retroactively as counterpart contribution expenses incurred by the GON, including the INSS, for the purposes of this project, after February 5, 1999 for hiring international legal and regulatory experts up to the amount of \$120,000, provided that policies and procedures required by the Bank and the MIF were followed.
SPECIAL CONTRACTUAL CONDITIONS:	<p>Prior to the disbursement of funds for components four and five and six of Part B the Technical Secretariat (SETEC) will submit to the satisfaction of the Bank evidence that: (i) legislation establishing a new pension system which contains, among others, the elements described in paragraph 3.3 has been approved (par.3.3); (ii) it has hired the Program Advisor and the Program Coordinator in accordance with terms of reference previously agreed upon with the Bank (par. 5.4)</p> <p>The Bank will cancel the resources of components four, five and six of Part B of the Program if condition (i) above is not complied with within 24 months from the date of the operation's approval by the Donor's Committee.</p>

I. DESCRIPTION

A. Eligibility of Country and Program

- 1.1 The Donors Committee of MIF declared Nicaragua eligible to receive every form of financing the 30th of March of 1995. The present program complies with MIF guidelines to grant financing under the technical cooperation facility according to article 3 section 2 (d) of the MIF charter which allows granting resources to Governments to strengthen regulatory entities. The proposal is also consistent with the recommendation to support the development of the legal regulatory and supervisory framework for the financial sector.

II. CONTEXT

A. Background

- 2.1 Problems. The current social security system in Nicaragua is administered by the Nicaraguan Institute of Social Security (INSS). The main problems of the system are: (1) Very low coverage, less than 15 % of economically active population, concentrated in the highly paid and stable urban jobs, especially in the public sector. (2) Insufficient benefits and contribution rates (5.5% of salary). The replacement rate is 36% of average salary (19% for survivors benefits) and pensions are not indexed to inflation, which results in a rapid erosion of their purchasing power. (3) High administrative cost (estimated at 15% of pension benefits) resulting from the inefficiency of the system (4) Increasing cost for the affiliates given the rapid demographic transition which is gradually reducing the number of contributors for each retiree. (5) Fiscal unsustainability, given that the system is already in deficit (0.8% of GDP in 1999, rapidly increasing), has insufficient and poorly managed reserves and requires a growing budgetary contribution from the Government.
- 2.2 Strategy of the GON. Since 1998 the Government of Nicaragua has undertaken a project to reform the pension branch (disability, old age and survivors or IVM) of its social security system¹. The GON has expressed its firm intention to structure the reform in two main pillars: (i) a so-called parametric adjustment to the current system, consisting primarily in a gradual increase in contribution rates and retirement age for workers older than 45, who will stay in the current system and (ii) the transition of all other workers to a new pension system based on the capitalization of contributions in individual accounts, to be pooled and administered by privately managed specialized companies (Pension Fund Administrators or AFPs), and invested in financial instruments in domestic and international capital markets, under the supervision of a specialized entity, the Pension Superintendency or SUPEN. The preliminary design of the reform has been drafted since mid-1998 by the pension reform commission (CREPEN), a technical unit within the INSS.
- 2.3 Steps already taken by GON. The Government has formally committed to the reform by appointing an Interministry Commission integrated by the Minister of Finance, the President of the Central Bank, the President of the INSS, and coordinated by the Technical Secretary of the Presidency of the Republic. The

¹ The other branch, related to health insurance has already been successfully reformed a few years ago.

Commission meets periodically to make key decisions on the reform process. It determined the main guidelines of the pension reform on November 20 1998 and presented to the Bank evidence of approval by the Commission and by the President of the Republic of the final design of the reform on May 7 1999 (these documents are both available in the program's technical files). The principles of the reform have also been informally discussed with the main political forces in the country.

- 2.4 IDB and World Bank involvement and expected timetable. At the end of 1998, the Government approached the World Bank and the IDB and requested both technical advice and financing for a comprehensive technical cooperation package to finalize the design of the pension reform as well as its implementation and other complementary measures in the financial sector. The World Bank has already initiated its support with a grant primarily used to carry out an actuarial analysis of the IVM in Nicaragua. In addition the WB is finalizing the preparation of a technical cooperation which will complement this MIF by sponsoring two key activities that are not included here: (i) the design and implementation of a public awareness campaign to involve civil society in the reform, (ii) measures to modernize the financial system in Nicaragua and promote the development of the insurance sector, the creation of financial instruments, and the establishment of risk rating agencies. The IDB support has been requested by the GON to prepare two crucial steps of the new pension system: (i) the establishment of an adequate legal and regulatory framework. GON expects to submit the pension reform legislation to the National Assembly in the second semester of 1999, (ii) the implementation of the reform, including the creation of a Pension Superintendency to supervise the system. GON expects to initiate implementation as soon as the legislation is approved. The transfer of workers, which officially starts up the new system, is expected once the Superintendency is fully operating and key complementary reforms are in place, tentatively at the end of 2000. It is important to stress that WB and IDB have formed a joint team and have worked together in the preparation of the respective operations in order to ensure maximum complementarity and avoid duplicating efforts.
- 2.5 Potential future IDB/WB operations. The GON also asked both the Bank and the World Bank policy reform loan to finance part of the transition cost to the new system. This cost is originated by the payment of pensions to current retirees and by the recognition of contributions of current affiliates who move to the new system. It is important to point out that (i) this cost is small compared to international standards (under the most likely scenario it is in the order of 1.5 percent of GDP in the first year declining to less than 1% in 10 years) and can be financed with a pool of measures that could reduce the need for external financing by multilateral institutions and; (ii) the cost will be generated over many years starting once the new system is fully underway. Given that having an operational Superintendency is necessary for transferring affiliates to the new system, this project represents a prerequisite for a possible policy reform loan of the Bank.
- 2.6 IMF support. The reform is supported also by the IMF and is included in the agenda of reforms to be carried out by the Government of Nicaragua in order to qualify for the HIPC debt reduction initiative.

B. Other IDB operations in Nicaragua

- 2.7 Structural reforms. The present operation complements other Bank efforts for strengthening the financial sector in Nicaragua. At the end of 1998 the Bank approved a financial sector loan (FSL) whose main objective is to support the modernization of the banking system and the withdrawal of the Government from the ownership and operation of commercial banks . This operation is being executed and the Bank is currently processing the disbursement of first tranche. Given the important implications of pension reform on the financial sector, a satisfactory implementation of the FSL and the continuous good performance under the ESAF program is also a prerequisite for the approval of a potential second phase operation which would finance a portion of the fiscal cost of the reform.
- 2.8 Technical Assistance. In September 1998 the MIF approved a program to modernize capital markets (ATN/MT-6157-NI) executed through the Central Bank of Nicaragua whose objectives are: (i) the preparation of the legal and regulatory framework for capital markets, (ii) strengthening the oversight of the Bank's Superintendency, (iii) the modernization of the clearance and settlement system, and (iv) the standardization of public debt instruments. The program's special contractual conditions were recently met and execution has started successfully.

III. OBJECTIVES AND DESCRIPTION OF THE PROJECT

A. Objectives.

- 3.1 The general objective of the program is to support the ongoing pension reform which aims at increasing coverage and benefits, improving the equity of the system and insuring its financial solvency in the long run. The specific objectives of this program are to prepare the two crucial steps needed before workers can transfer to the new pension system: (i) the establishment of an adequate legal and regulatory framework for the new pension system (ii) the design and implementation of an appropriate supervisory oversight on the system. These objectives will be pursued in two separate and sequential steps as explained below.

B. Project's Description

- 3.2 The project is articulated in two parts. As detailed in Section VIII below, Part B will be initiated once an adequate legal framework is approved to the satisfaction of the Bank.

Part A. Legal and regulatory framework for the reform.

Component 1. Draft legislation and regulation. (US\$ 360.000)

- 3.3 Description. An adequate legislation and regulation is crucial to ensure the proper functioning and viability of the new pension system. As mentioned in paragraph 2.3, the GON has already completed the technical design of the new pension system and discussed it with the main political forces of the country. This design needs to be translated into a draft law to be submitted to the National Assembly. The law will determine the main elements of the system such as: (i) general

provisions,² (ii) regulation of the AFPs³, (iii) rules for the administration of benefits⁴. A separate law will contain the structure, functions and responsibilities of the SUPEN as the regulatory body. Complementary regulation will define important aspects such as the investment rules for pension funds, the criteria to evaluate AFPs portfolios, the custody of assets, the role of the INSS etc.

- 3.4 Importance of investment rules. The operation mentioned in par 2.8 together with other potential MIF projects under consideration⁵ will help achieving the fundamental objective of gradually preparing a set of financial products in which the pension funds could eventually invest. Projections indicate that the expected flow of funds in the new pension system will be relatively small for a number of years, given the low coverage of the current system and the low average salary of affiliates. However the Bank is well aware of the current lack of instruments in Nicaraguan markets, the problems associated with investing pension funds predominantly in Government debt and the need to maintain stability in the local financial markets. Therefore this component will also support the establishment of adequate investment rules for pension funds.
- 3.5 Execution. This component will support the preparation of the draft laws and draft regulations for the new pension system, as well as the basic regulation and norms needed for its implementation. The program's resources will be used to hire international experts, preferably with specific previous Latin American exposure, in the fields of: pension law, regulation and supervision of pension funds, and financial markets legislation. In addition, given the importance of protecting pension savings from the high risks associated with emerging capital markets, the program will hire an international risk analyst to conduct a study of the financial instruments available in the Nicaraguan market and make recommendations on fundamental issues including among others the need and the size of: (i) a ceiling for pension fund investment in every instrument, (ii) a minimum percentage of pension funds to be invested in highly rated foreign instruments (iii) minimum requirements of portfolio adjustments to be made by AFPs over time as the system matures. Once this study is completed, the Technical Secretariat will submit to the Bank for its acceptance, a proposal for incorporating the study's recommendations in the regulation of the new pension system.

Component 2. Training for legislators (US\$ 80.000).

- 3.6 Description. The understanding of a pension reform often involves a high degree of technical knowledge due to the interdisciplinary nature of such reform and its likely impact on the financial sector. In order to stimulate political acceptance of the pension reform law and mitigate the main risk of this project (see par.6.2), it is

² These include participation criteria, affiliation to AFPs and switching rules, level of contributions by workers and employers, collection procedures, separation of premia for disability and survivorship insurance, tax exemptions and other general provisions.

³ Such as requirements for the incorporation, licensing procedures, minimum capital, conflict of interest, permitted activities, marketing, accounting, publicity and transparency in the provision of information, separation of administered funds, liquidation and foreclosure procedures.

⁴ These are: required age, contribution history, certification of eligibility for the different schemes, recognition of acquired rights under the old system, retirement benefits alternatives, extent of any Government guarantee.

⁵ These include the creation of the regional prospectus for issuing private and public sector instruments in Central American stock markets, and the promotion of mortgage securitization

important to support training activities directed to the legislators and aimed at increasing their awareness of the main problems of the current pension system and the main alternatives of reform.

- 3.7 Execution. The program resources will be used to provide information and training to the members of the National Assembly, particularly to members of the legislative commission which will examine the draft pension reform laws. Eligible activities include courses, seminars, workshops, contact with legislators in other countries⁶, preparation of written or audiovisual material and the formulation of best practices related to other countries in the region.

Part B. Reform Implementation.

Component 3. Implementation strategy. (US\$ 110.000)

- 3.8 Description. The pension reform envisaged by the GON is a deep structural change that will affect the provision of social security, redefine the responsibility of the Government's INSS in this area and require a gradual modernization of the financial sector. This component will support the formulation and execution of the GON implementation strategy for the reform. The strategy will include all necessary steps for the implementation of the laws approved by the National Assembly, the formulation of follow-up regulation, the coordination of the pension reform with other reform efforts being pursued in the financial sector and the design and implementation of a transition phase to help the INSS modernize and play the role assigned to it by the law.
- 3.9 Execution. Project's funds will be used to hire one international consultant with strong management skills and exposure to financial sector reforms in the Region as a strategic support to the project executing agency (see Section V below). This consultant will formulate a comprehensive implementation strategy for the pension reform and a follow closely its execution.

Component 4. Establishment of the Pension Superintendency (SUPEN).

(US\$ 600.000)

- 3.10 Description. The existence of a specialized institution which oversees the new pension system is fundamental for its functioning and long term viability. After careful analysis the GON opted for creating a new Superintendency of the Pension System (SUPEN), rather than expanding the mandate of the existing SBIF because: (i) the SBIF is currently undergoing a major restructuring to strengthen its ability to oversee the stock market and this will commit its full institutional capacity, (ii) previous international experience shows that the supervision of the pension system demands a high level of specialization and independence, easier to achieve in a separate entity, (iii) additional operating cost resulting from setting up the SUPEN is expected to be not significant and, once the system is fully implemented, largely covered by a small portion of workers' contributions to the pension system, to be regulated.
- 3.11 The core functions of the SUPEN include: (i) to license prospective AFPs before they can operate, (ii) to interpret pension legislation and issue implementing regulation, (iii) to oversee and monitor the pension system, by collecting relevant

⁶ According to MIF guidelines, any training initiatives that involve traveling of Nicaraguan staff outside the Latin American region can only be financed with counterpart resources.

information from the AFPs and conducting random audits, (iv) to sanction AFPs as established by the law (v) to disseminate relevant information on the pension system, such as costs, returns, benefits.

- 3.12 This component will support the creation and start-up costs of the SUPEN through the definition of: (i) the legal nature of SUPEN and the requirements for its establishment as an autonomous entity, adequately funded and directly accountable to the GON, (ii) institutional aspects, such as the organizational structure and the human resources strategy. The SUPEN is expected to be a small entity employing professionals with high technical level, competitively selected and possibly compensated according to a separate scale from that of public employees, (iii) financial aspects, such as the accounting and budget scheme, and sources of financing including definition of the contributions from AFPs and of funding required by the government in the start up phase, until enough assets have been accumulated by AFPs. The objective is to ensure the financial independence of SUPEN. (iv) operational aspects, such as the design of the main operation processes, decision flows, and responsibilities of the different units of SUPEN, and (v) technical aspects, such as the accounting plan for the supervised entities, the information standards reported to the SUPEN, the inspection manual and information procedures.
- 3.13 Execution. The funds of this component will be used to hire international consultants, either firms or individuals, with experience in the legal, institutional, financial, and technical design of financial sector regulatory entities, preferably with experience on pension superintendencies in Latin America. Consultants to be hired in this component are expected to make the SUPEN operational. A subsequent institutional strengthening phase to be focused on the main requirements of the new SUPEN is envisaged, and is included in the WB technical cooperation parallel to this operation (par. 2.4).

Component 5. Information systems for the SUPEN. (US\$ 380.000)

- 3.14 Description. An advanced management of information is the key factor for an effective oversight of the pension system. Treatment of information includes capture, testing, analysis, evaluation, reporting, dissemination, storage as well as interaction with other entities.
- 3.15 This component will support the design and implementation of an information systems plan for SUPEN, which will include a network integration with the supervised entities and with the SBIF. The expected result is that SUPEN will be able to monitor in real time the AFPs, obtain from them the required information online and exchange data with SBIF.
- 3.16 Execution. The resources of this component will finance an international expert in the design of information systems, preferably with prior work in financial sector supervisory entities. This consultant will be responsible for: (i) designing a comprehensive information system plan for the SUPEN. The plan will define the structure of the system, hardware and software specifications, network properties, maintenance procedures, technical training for users, implementation timetable, and budget, (ii) assisting the SUPEN in the successful execution of the plan. A local firm is expected to be hired for the execution phase. Other eligible activities

to be financed with this component include acquisition of hardware, purchase or development of software, and computer training activities included in the plan.

Component 6. Training. (US\$ 190.000)

- 3.17 Description. A comprehensive training program is required both as a means to attract and retain qualified personnel in the SUPEN and as an essential instrument to keep the Superintendency up to date in the rapidly changing pension business. Therefore training will be primarily directed to SUPEN staff and focused on strengthening its ability to effectively monitor the new pension system. Potential training areas include the control of AFPs in : (i) procedures related to affiliation, fees, record keeping, customer service (ii) marketing practices and switching between AFPs (iii) investment of pension funds (iv) administration of benefits. There will be flexibility with respect to the type of training that the program may sponsor, and eligible training includes courses, on the job training, seminars, workshops, experience in a foreign pension Superintendency⁷, preparation of written or audiovisual material, best practices among other countries in the region.
- 3.18 The promotion of a continuing dialogue between the SUPEN and supervised entities regarding the progress in the implementation of the reform and the adjustments to be made to the system is also eligible to be financed under this component.
- 3.19 Execution. An international consultant with experience in training programs, preferably for supervisory entities will be hired to design a detailed training plan, including the definition of objectives, beneficiaries, eligible activities and budget. In order to ensure the continuity of training activities beyond the execution of this program, the plan will also identify long term training objectives and modules for the SUPEN, estimate resources needed yearly and identify potential ways of financing them. Other experts may be hired to assist in the implementation of the training plan. It is expected that some training activities will be carried out with additional funds to be obtained by SUPEN from international donors or national sources.

⁷ According to MIF guidelines, any training initiatives that involve traveling of Nicaraguan staff outside the Latin American region can only be financed with local counterpart resources.

IV. COST AND FINANCING OF THE PROJECT

- 4.1 The cost of the program is US\$2,000,000, including financing by the MIF of US\$1,200,000 and local counterpart contribution of US\$800,000 which represents 40 percent of total financing. According to MIF guidelines 50% of local counterpart contribution will be provided in cash. Counterpart funds will be provided by the Technical Secretariat of the Presidency of the Republic, which is the executing agency.

Program's Budget MIF/TC-99-02-O1-0 (US\$.000)

ACTIVITY	MIF	LOCAL	TOTAL	%
PART A. Legal and regulatory framework of pension reform	280	160	440	22.0%
Component 1. Draft laws and regulation	220	140	360	18.0%
1.1 Experts in pension law, pension supervision, financial sector regulation	150	140	290	14.5%
1.2 Risk analysis expert for investment rules	70	0	70	3.5%
Component 2. Training for legislators.	60	20	80	4.0%
PART B. Reform Implementation	740	540	1280	64.0%
Component 3. Implementation strategy	110	0	110	5.5%
3.1. Consultant of the Technical Secretariat	110	0	110	5.5%
Component 4. Establishment of pension Superintendency	430	170	600	30.0%
4.1 International experts in the legal, administrative, financial, and technical design of financial sector supervisory entities	430	110	540	27.0%
4.2 Other expenses	0	60	60	3.0%
Component 5. Information system of the SUPEN	140	240	380	19.0%
5.1 Experts in the design and implementation of information systems	110	0	110	5.5%
5.2 Hardware, Software and equipment.	30	240	270	13.5%
Component 6. Training	60	130	190	9.5%
6.1 Consultants	60	80	140	7.0%
6.2 Materials and other expenses	0	50	50	2.5%
7. Other expenses	180	100	280	14.0%
Program Advisor	80	0	80	4.0%
Program Coordinator	0	100	100	5.0%
Program Audit	50	0	50	2.5%
Contingency	50	0	50	2.5%
TOTAL	1200	800	2000	100.0%
%	60%	40%	100%	

V. EXECUTION

A. Executing Mechanism and Agency.

- 5.1 The Technical Secretariat of the Presidency of the Republic (SETEC), which is responsible for the overall coordination of the pension reform, is the project executing agency⁸. Other entities involved in the implementation of this project are the Interministry Commission, the Pension Reform Technical Commission (CREPEN) and the Program Advisor.
- 5.2 As mentioned in paragraph 2.3, the Interministry Commission is a decision-making body at the Ministers level coordinated by the SETEC. The Commission meets periodically to take a formal GON decision on key aspects of the reform. In the implementation of this project, the Commission will maintain this high level decision-making role and will be responsible for coordinating activities among all government agencies involved in the reform (SBIF, Central Bank, Ministry of Finance).
- 5.3 The CREPEN, a small technical unit of the Social Security Institute (INSS), is responsible for coordinating activities in Part A under the direction of the SETEC. Its role is to provide information, recommendations and feedback to the international consultants to be contracted to prepare the draft laws and regulation envisaged in Part A.
- 5.4 The Program Advisor will be an international consultant, hired by the Technical Secretariat to take responsibility for coordinating activities of Part B including: (i) Finalizing action plans and preparing a detailed budget for each one of the components, (ii) Coordinating the activities of the consultants to be contracted, reviewing and approving their reports before submission to the Bank. (iii) Supervising implementation, presenting a brief progress report to the Bank every three months and a detailed report once a year. The latter will include a description of activities and results obtained, a detailed justification for expected activities and results not achieved and a plan of actions for the following year, with a revised budget. The Program Advisor, will be assisted by a full time Program Coordinator to be hired with counterpart funds for the execution of Part B.

B. Disbursements.

- 5.5 Given that the executing agency is already in place, disbursement of Part A is not linked to any special conditions and can start as soon as the general contractual conditions are met. The resources corresponding to components of Part B may be disbursed independently from each other but the disbursement of funds for components four and five and six of Part B will be made only after the special contractual conditions mentioned in Section VIII below have been met.

C. Project Supervision

- 5.6 Part A will be supervised directly by the Bank. Supervision of Part B will be a responsibility of the Program Advisor who will be also provide periodic reports to the Bank as specified in par. 5.4 above.

⁸ Administrative aspects such as contracting, procurement, disbursements etc will be carried out by the SETEC through the existing project implementation unit, which has previous experience in implementing projects with multilateral agencies. This unit is now within the INSS but will be made directly accountable to the Technical Secretariat upon starting project's implementation.

D. Beneficiaries.

- 5.7 The direct beneficiaries of the project are the pension reform technical commission for Part A, and the Pension Superintendency for Part B. Indirect beneficiaries are all Nicaraguan workers who will benefit from the sound legal foundation and effective oversight of the new pension system.

E. Execution Period.

- 5.8 The execution period of the project is will be 36 months, and the disbursement period will be 40 months.

VI. JUSTIFICATION AND RISKS

- 6.1 The project's direct justification is to assist the Government of Nicaragua in finalizing and implementing the far reaching structural reform of Social Security that the GON has designed. The reform is aimed at improving the performance of the current system in terms of coverage, replacement rates, equity and financial sustainability. Once the transition period is completed, the reform is also expected to have a positive macroeconomic impact for it will not require a large and increasing amount of resources to be transferred from the Government budget to the INSS every year. Spillover effects that the reform does not pursue but might induce, include developing domestic capital markets, opening of the financial sector to foreign investment, and modernizing the insurance business, banking and asset management. This project is designed to ensure that Nicaragua benefits from the experience of other countries in designing the type of pension reform that best suits its needs and current situation.
- 6.2 This project faces two main risks: (1) Difficulties in approving the reform. Once a draft pension reform law has been prepared and reviewed by the Government with the assistance of this program, the law will be discussed in the National Assembly. Approval in the Assembly may prove to be lengthy, given the political sensibility of social security. The Government is aware of this problem and has expressed its willingness to: (i) involve the members of the National Assembly in a specific training program aimed at increasing their awareness of the problems of the current pension system and the main alternatives for reform. The Program will support this initiative with component 2, (ii) seek a broad political consensus on the reform, by involving civil society in a large and proactive awareness campaign. The World Bank's technical assistance package parallel to this MIF will finance such campaign.
- 6.3 (2) Successful implementation of the reform. Given the complexity of the reform and the relatively incipient financial sector in Nicaragua, there is a risk that full implementation may be difficult to achieve in a short time. Both the Government and the Bank are aware of this risk and have already taken steps in order to mitigate it. These include: (i) component 3 of this project which will support the GON in designing and carrying out the implementation strategy for the reform, (ii) a careful analysis of local financial markets, with the objective of identifying a set of measures to complement the reform. These measures will be supported by the

parallel WB technical cooperation package which complements this operation. Component 2 of this MIF program will also contribute to that end by establishing prudential investment rules for pension funds, (iii) a continuing technical dialogue between government officials, IDB and WB staff and external consultants each one of the major design alternatives of the reform and on the steps due in the implementation phase.

- 6.4 Particular attention will be devoted to establishing an appropriate coordination between SBIF and SUPEN. The Bank is currently engaged in executing a MIF operation for the modernization of capital markets in Nicaragua. This operation includes a component to strengthen the SBIF by restructuring it and promoting a better supervision of the stock market. Part B of the proposed operation will benefit from the lessons learned in this program and the joint execution will insure a strong coordination from the IDB Representation.

VII. RETROACTIVE RECOGNITION OF COUNTERPART

- 7.1 Activities under Part A are already in preparation. It is proposed that the Bank may recognize retroactively as counterpart contribution expenses incurred by the GON, including the INSS, for the purposes of this project, after February 5, 1999 for hiring international legal and regulatory experts up to the amount of \$120,000, provided that policies and procedures required by the Bank and the MIF were followed.

VIII. SPECIAL CONTRACTUAL CONDITIONS

- 8.1 Prior to the disbursement of funds for components four and five and six of Part B, the Technical Secretariat (SETEC) will submit to the satisfaction of the Bank evidence that: (i) legislation establishing a new pension system which contains, among others, the elements described in paragraph 3.3 has been approved; (ii) it has hired the Program Advisor and the Program Coordinator in accordance with terms of reference previously agreed upon with the Bank.
- 8.2 The Bank will cancel the resources of components four, five and six of Part B of the Program if condition (i) above is not complied with within 24 months from the date of the operation's approval by the Donor's Committee.

NICARAGUA: SUPPORT TO THE LEGAL FRAMEWORK OF THE NEW PENSION SYSTEM AND CREATION OF THE PENSION SUPERINTENDENCY

MIF Technical Cooperation Facility			
<u>Summary of Objectives, Results and Activities of the Program</u>	<u>Indicators</u>	<u>Sources of Verification</u>	<u>Assumptions</u>
General Objectives: to support the government's commitment to a structural pension reform.			
Specific Objectives: to prepare the two crucial steps needed before workers can transfer to the new pension system: (i) an adequate legal and regulatory framework and (ii) the implementation of an appropriate supervisory oversight on the system.	Pension Reform Law approved. Pension Superintendency (SUPEN) operational.		Continuing commitment of the Government and acceptance by the National Assembly.
Component I: Preparation of a draft legal framework for the new pension system to be submitted to the National Assembly and preparation of regulation necessary for its implementation.	Pension reform law and Pension Superintendency law presented to the National Assembly (approval of these laws is expected as a result component 1 and 2 of this program as well as the WB parallel operation. See par. 6.2).	Government letter submitting law to National Assembly.	Continuing commitment of Government
Component II: Training to legislators, aimed at increasing their awareness of the main problems of the current system and alternatives of reform.	Training activities regarding technical aspects of the pension reform are held with the attendance of key members of the National Assembly.	Participants in the training program.	Interest from members of the National Assembly in the training organized.
Component III: Support to the GON for the formulation and execution of an implementation strategy for the reform	Implementation plan formulated and being executed.	Periodic reports to the Bank from the Program Advisor (par.5.4).	Approval of adequate legal framework
Component IV: Establishment of the Pension Superintendency, including design and implementation of legal, institutional, administrative, financial and technical aspects.	Pension Superintendency operating.	Pension Superintendency starts issuing regulation to AFPs.	Adequate initial financial contribution from the Government until the new pension system is underway.
Component V: Information systems for the Superintendency, including internal system and online connection to the supervised entities	Superintendency collects data online from AFPs and shares it with SBIF.	Periodic reports to the Bank from Program Advisor (par.5.4)	Cooperation from AFPs in releasing required information.
Component VI: Training program for the personnel of the Superintendency and other key players in the reform.	Training plan approved by the Program Coordinator and being implemented.	Training activities for SUPEN staff carried out	Interest in training activities.

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PROPOSED RESOLUTION

NICARAGUA. NONREIMBURSABLE TECHNICAL COOPERATION FOR SUPPORT TO THE LEGAL FRAMEWORK OF THE NEW PENSION SYSTEM AND CREATION OF THE PENSION SUPERINTENDENCY IN NICARAGUA

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the República de Nicaragua, and to take such additional measures as may be pertinent for the execution of the project memorandum referred to in Document MIF/AT-_____ with respect to a technical cooperation for Support to the Legal Framework of the New Pension System and Creation of the Pension Superintendency in Nicaragua.
2. That up to the amount of US\$1.200.000, or its equivalent in other convertible currencies, is authorized for the purpose of this resolution, chargeable to the resources of the Technical Cooperation Facility of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.