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**MINISTRY OF FINANCE
FINANCIAL MARKETS PROJECT**

**SOE RESTRUCTURING AND
PRIVATIZATION COMPONENT**

SOE Pension Funds

Draft Report

September, 1992

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INDONESIA FINANCIAL MARKETS PROJECT
MINISTRY OF FINANCE



September 1992

Ir. Martiono Hadiano, MBA
Director General
Directorate General of State Enterprises
Ministry of Finance

Dear Bapak Martiono:

Re: **AID/PRE-Privatization and Development Project (PAD)**
Contract No. DPE-0016-Q-00-1002-00
USAID/Indonesia-Financial Markets Project (FMP) (Privatization Component)
PIO/T No. 497-0360-3-100087
Task 2.5 - SOE Pension Funds: Draft Report

Enclosed please find seven (7) copies of the Draft Report for Task 2.5, SOE Pension Funds, as prepared under the FMP SOE Restructuring and Privatization Component. This Draft Report was prepared by Alberto Libedinsky, a pension funds specialist, and Deborah Dungan of Price Waterhouse's Washington office, working closely with Andung Nitimihardja and Sondang Gultom, whose guidance was invaluable in carrying out this assignment. Mark Camstra, FMP Chief of Party, and I provided technical and managerial oversight.

The new law concerning pension funds will require substantial changes in the way pension funds, including SOE pension funds, are structured and operated if they are to enjoy the advantages of operating under that law, including tax benefits. SOE pension funds will have to make decisions regarding adaptation to this law in the coming months. As you know, the deadline for pension funds to comply with the law is April 1993, seven months from now. For this reason, and because SOE pension funds represent both a fiduciary obligation of a great magnitude and a very large pool of investable funds, it would seem desirable for the Directorate General of State Enterprises (DGSE) to establish, as quickly as possible, a means of regulating and supervising SOE pension funds in an appropriate manner.



These funds are currently monitored and supervised only loosely by the DGSE. At the end of each fiscal year, many SOE pension funds are faced with unexpectedly high expenditure demands which require additional contributions to be made by the Government. The DGSE, as the owner's representative, is in most cases required to provide funds to cover these shortfalls, but currently has no comprehensive and systematic means of monitoring or controlling SOE pension funds' costs. It is important that the DGSE begin as soon as possible to develop guidelines, taking into account the basic structure created by the new Pension Funds Law, to improve the efficiency and financial viability of SOE pension funds. This would help eliminate the demand for additional funding from the Government.

This Draft Report lays out an approach that could be followed by the DGSE in formulating comprehensive policies and guidelines that will allow it to supervise the design and operation of SOE pension funds. The basic findings and conclusions of the team carrying out this project are presented, and recommendations are made that could serve as a basis for a comprehensive supervisory system.

The Draft Report also presents a program for implementing the recommendations and developing a supervisory system. This program is based on use of DGSE in-house resources as the primary means, supplemented by outside assistance to the extent necessary and appropriate. The precise nature and timing of this implementation program would be shaped by key decisions you make with respect to the overall strategic direction of the Directorate General, and are contingent on progress made on personnel selection and training, and on the implementation of a DGSE-wide management information system.

We look forward to your review of and comments on this Draft Report. We remain at your disposal to discuss the next steps which may need to be taken.

Once we have received any Directorate comments on this Draft Report, we will prepare a Final Report reflecting your guidance.

Sincerely,

William Hollinger
FMP Senior Privatization Advisor

cc: Jon Lindborg, FMP Project Officer, USAID/Indonesia
Auguste E. Rimpel, FMP Partner, PW/Washington

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EXECUTIVE SUMMARY

A. Background and Project Objectives

1. Background

- Prior to 1992, no comprehensive set of regulations governing pension fund operations existed in Indonesia. A new Law Concerning Pension Funds, Law No. 11/1992 dated April 20, 1992, provides a basic legal structure and guidelines for pension funds. Existing SOE pension funds must make a decision regarding adaptation to this law, and will need to do so by April 20, 1993, one year after the date of promulgation.
- The Directorate General of State Enterprises (DGSE) is responsible for formulating policies for and monitoring the performance of state-owned enterprises (SOEs), including the design and operation of SOE pension funds. To fulfill its responsibilities, the Directorate General will need to consider formulating comprehensive policies and setting guidelines that will allow it to regulate and supervise the design and operation of SOE pension funds in an appropriate fashion.

2. Objective

- The objective of this report is to assist the DGSE to undertake an assessment of the pension arrangements of SOEs and to make recommendations on operational guidelines to be established by the Directorate General, taking into account the options created by the new Pension Funds Law, in order to assure efficient and responsible management of SOE pension funds.
- The purpose of this report is limited to recommending broad guidelines which would shape the detailed instructions to be issued by the DGSE. These guidelines are intended to:
 - Provide a structured set of standards, operating procedures, and reporting requirements within which SOE pension funds would operate.
 - Facilitate the monitoring and supervision of SOE pension funds by the DGSE.

B. Key Findings and Conclusions**1. The New Legal Environment and its Impact on SOE Pension Funds**

- It appears likely that domestic financial institutions, including pension funds, will become increasingly sophisticated and increasingly active in the capital market. A new legal environment is being defined which, when implemented, will encourage competition and rapid transformation of financial and investment activities.
 - a) *The Pension Funds Law*
- The new Pension Funds Law is a solid and comprehensive framework which allows a variety of pension arrangements and a wide degree of choice and flexibility to companies in designing pension plans.
- Implementing regulations to support the law will be issued at two levels -- Governmental (issued by the President) and Ministerial (issued by the Minister of Finance). To date, neither set of regulations has been issued. Drafts of these regulations were not available for review.
- A company which has or wishes to establish a pension program must register with the MOF and conform to the new Pension Funds Law unless it bases its pension program on the new Insurance Law. If a company enrolls its employees in a group pension plan offered by an insurance company, in accordance with the Insurance Law, the pension program need not be registered with the MOF. It should be noted, however, that no tax advantages will be granted to such pension funds, and there will be a lack of government supervision.
- Two basic types of pension funds are permitted by the new law -- Employers Pension Funds, or EPFs (established by one or more companies), and Financial Institution Pension Funds, or FIPFs (established by banks or life insurance companies). Within this framework, a company can choose for some or all of its employees to:
 - 1) create its own pension fund (EPF),
 - 2) join a pension fund established by another employer (EPF), or
 - 3) enroll its employees in a financial institution pension fund (FIPF).

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- Employers' Pension Funds are permitted to have agreements with third parties to provide pension management services and, if the party is a licensed investment manager, investment management services. EPFs are required to contract custodial services with banks or other authorized entities to safeguard their assets.

b) The Social Security Law

- A new Law on Workers' Social Security, Law No. 3/1992, was promulgated in February 1992. This law prescribes mandatory participation by all employers in a nationwide social security program that provides basic benefits for employees.
- The preparation of implementing regulations for the Social Security Law is in process. These implementing regulations are likely to have an impact on pension programs established by companies, including SOE pension funds.
- The Social Security Law and the Pension Funds Law complement each other; both constitute clear and modern policies on social insurance benefits.
- The result of these two laws will be a two-tier system:
 - All employers with more than 15 employees will participate in the compulsory national social security system, administered by Government-owned companies.
 - An employer can choose to complement the basic benefits offered by the social security system by establishing or participating in an additional pension program for all or part of its employees.

c) Other Relevant Laws and Decrees

- In addition to the new Pension Funds Law and Social Security Law, new laws on insurance and banking and decrees governing the capital market have been recently promulgated. These laws and decrees will have an impact on the pension funds industry, in that they provide guidance on the types of relationships that can be established between pension funds (including SOE pension funds) and insurance companies and supporting industries, banks and their related financial institutions, and securities companies.

2. Current Operations and Practices of SOE Pension Funds

- To date, the scope and role of pension funds in Indonesia has not been large, as few companies or individuals outside of the Government have chosen to participate in a pension program. The impact of pension funds in the domestic financial sector has been minor, and investment supervision and guidance by Government authorities has been slight.
- Despite their limited scope in Indonesia in general, however, pension funds are widely used by SOEs as part of their total benefits package -- virtually all SOEs currently have some type of pension program. The scope of these SOE pension funds is significant: as of the end of 1991, total assets of more than three trillion Rupiah (approximately US\$1.5 billion) had been accumulated by SOE pension programs.
- Because there are no specific regulations governing SOE pension funds, SOEs currently follow a wide variety of practices regarding policies, structure and operation of pension funds.
- Most SOE pension funds are registered with the MOF and have adopted the legal structure (*yayasan dana pensiun*) which allows tax concessions on contributions to pension funds and on returns from certain types of investments.
- In many SOEs, a large portion of the work force is composed of "non-staff" (i.e., temporary) workers who are not eligible to participate in the company's pension program.
- In most cases, contributions to SOE pension funds are made by both the employees and the employer.
- Virtually all, if not all, SOE pension funds are *defined benefit* programs, which provide a wide variety of benefits. Benefits typically include retirement benefits paid as a lump sum and/or in monthly installments, death benefits for the employee's widow/widower and children, and disability benefits.
- Management of SOE pension programs is conducted either in-house, often by the company's Personnel Department, or by an outside pension fund manager. Outside pension fund managers are usually state-owned insurance companies, although some SOEs use private insurance companies for this purpose.

- Training, development of skills, and adequate compensation for the SOE staff responsible for managing or overseeing pension funds has not been given a high priority. In many cases, management of SOE pension funds is carried out by high-ranking retired employees of the SOE, most of whom do not have expertise in pension or investment management.
- Participation by employees in the establishment and management of SOE pension plans is almost nonexistent. Participants generally have a very low level of understanding of their pension plans, as they are rarely provided with any information about its current status.
- For the most part, when SOE pension funds were established, prior years of service with the company were recognized, creating sizable funding requirements. In a few instances, past service liabilities have been funded, but more frequently a large balance remains unfunded. In some cases, current employer contributions are also unfunded.
- At the end of each fiscal year, many SOE pension funds are faced with unexpectedly high costs which require additional contributions to be made, often by the Government. The unexpected costs are, in part, a result of the fact that cost controls have not been established by most SOE pension funds. There seems to be a widespread lack of awareness of both the administrative costs of operating pension programs and the costs of benefits provided.
- Most SOE pension funds do not appear to have clearly defined investment objectives or the expertise needed to deal with portfolio management.
- SOE pension funds invest primarily in time deposits, mostly in state-owned banks. Other important forms of investment by SOE pension funds include bonds, real estate and venture capital in companies related to the founder.

C. Recommendations**1. Ministry of Finance Recommendations**

While the scope of work for this project focused specifically on SOE pension funds, the analysis has suggested some recommendations concerning the general pension fund environment in Indonesia. We respectfully submit these recommendations for consideration by the Ministry of Finance.

- #1. Any constraints on life insurance companies providing a full range of services to pension funds, including pension and investment management services, should be reconsidered. The Insurance Law and the Capital Market Decrees appear to indicate that life insurance companies are precluded from providing such services. There are several reasons why life insurance companies should be allowed to offer a full range of services, not the least of which is the fact that they are among the few entities capable of doing so.**
- #2. The creation and development of specialized pension management and investment management entities should be supported, particularly through joint ventures with internationally experienced companies. Both pension management and investment management are increasingly sophisticated and technology-intensive, and require qualified personnel.**
- #3. The GOI should consider encouraging the creation of a financial instrument rating capacity in Indonesia. This is a long-term prospect, but could play an important role in ensuring that adequate information is available on different investment instruments. Control of the risks assumed by pension funds, through regulations allowing them to acquire only rated instruments of certain classes, would be facilitated by the existence of a financial instrument rating capacity to be developed over time.**

2. Directorate General of State Enterprise Recommendations

This section contains a series of recommended guidelines that could serve as the basis for the DGSE to develop an effective system for regulating and supervising SOE pension funds.

a) Strategic Recommendations

- #4. **Establishment of pension funds by SOEs should be voluntary. Virtually all SOEs today have some type of a pension program, but the DGSE should not require an SOE which currently does not have one to establish a pension fund.**
- #5. **All SOE pension funds should be required to conform to the new Pension Funds Law. SOE pension funds should, however, have a choice on how to achieve this compliance. SOE pension funds should be required by the DGSE to adapt to the new Pension Funds Law in as short a period as possible, taking into consideration the financial strength of each SOE and SOE pension fund.**
- #6. **The DGSE should require SOE budgets and balance sheets to reflect the requirements of their pension funds. Both SOE annual budgets and SOE long-term plans should include pension fund requirements, based on actuarial calculations.**

b) Operational Recommendations

Goals, Type and Structure of Fund:

- #7. **SOE pension programs should be integrated with the company's overall human resource development strategy. The DGSE should encourage SOEs to design their pension programs as part of the broader subject of employee benefits.**
- #8. **The DGSE should not dictate to SOEs the type--defined benefit (DB) or defined contribution (DC)--of fund they can operate. Both types of plans should be permitted, and SOEs allowed to choose which type best meets their needs, working within a regulatory framework defined by the DGSE.**

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- #9. **The DGSE should, however, advise and assist SOEs in choosing between DB and DC plans, if requested. Both DB and DC plans have distinct advantages. The DGSE should be ready to assist SOEs in understanding the differences between these two types of pension funds and the advantages of each type.**

Defined contribution plans allow employers to share the risks of their pension programs with their employees, thus reducing the potential need for unpredicted resources. For this reason, the DGSE may want to encourage SOEs operating in a competitive environment, who require clear projections of current and future financial needs, to consider DC pension plans.

- #10. **Given the present level of development of the pension industry in Indonesia, the DGSE should not encourage SOEs to implement profit-sharing pension plans at this time. An exception might be financially weak companies, which may not have other alternatives. Profit-sharing plans do not impose a fixed commitment upon employers, and allow most of the risk to be shifted to employees, but they offer uncertain levels of benefits.**
- #11. **The DGSE should require all SOE pension funds to have a well-articulated statement of purpose. An organization's statement of purpose typically defines its intended beneficiaries, the "products" or "services" it provides them, and how its performance is to be measured. A statement of purpose is critically important in that it guides the definition of an organization's objectives, functions, structure and personnel requirements, and sets the tone for its day-to-day operations.**
- #12. **The DGSE should require SOE pension funds to become fully funded in as short a time as possible. Fully funded systems encourage financial discipline, actuarial awareness and a long-term perspective.**

Pension Management:

- #13. **The independence of pension funds from SOEs should be clearly established. SOE pension funds should be managed as entities separate from their founding companies, in order to improve performance, enhance operational autonomy, and devote pension fund resources solely to support pension benefit programs.**

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- #14. **The DGSE should require SOE pension funds to use external, professional pension management services, making exceptions on a case-by-case basis only. Unless an SOE has specific approval from the DGSE to manage its own pension fund, it should be required to use an outside pension manager. Use of professional, experienced managers is likely to greatly enhance the performance and strengthen the financial viability of SOE pension funds.**
- #15. **Participants' representatives to an Employer's Pension Fund's Board of Supervisors should be chosen directly by the participants, including pensioners. Guidelines issued by the DGSE should make it clear that the founder does not have the right to reject the representatives chosen by participants.**
- #16. **Accounting standards to be used by SOE pension funds should be established, and the format and frequency of reports to be submitted by them stipulated. It is important that the DGSE receive financial statements in a uniform format, using the same basic accounting principles, preferably conforming to internationally accepted standards.**
- #17. **The DGSE should require SOE pension funds to undergo a yearly audit of the fund's financial statements by independent external auditors.**
- #18. **The DGSE should establish uniform actuarial assumptions for the purpose of comparing and ranking SOE pension funds. For the purpose of estimating long-term costs and preparing financial statements, however, each SOE pension fund should be allowed to establish actuarial assumptions appropriate for its own situation and needs.**
- #19. **The DGSE should require all SOE pension funds to use professional actuaries in the preparation of financial statements.**

Contributions, Benefits and Participants' Rights:

- #20. **The DGSE should not require SOEs to include all employees in their pension programs, although they should be encouraged to include as many employees as possible. If different levels of benefits are to be offered to different groups of employees, separate pension programs should be used.**

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- #21. Employees should be required to make contributions to SOE pension funds. Sharing responsibility for the costs of a pension program increases awareness among employees.**
- #22. Contributions to pension funds and benefits received should be calculated from base salary plus allowances. Most SOEs today use base salary only when calculating contributions to pension funds and benefits to be received. Because base salaries are often only a small part of an employee's gross compensation, this can lead to artificially low levels of contributions and benefits.**
- #23. SOEs should be subject to stiff penalties for making late employer contributions to pension funds. The Pension Funds Law stipulates that if an employer does not pay its pension fund contributions on a monthly basis, it must pay interest on the late funds equivalent to the deposit rate used by government-owned commercial banks. The intent of this article is to ensure that pension fund participants receive a return even if the employer does not make contributions on time; a practical side effect of the article, however, is to make pension fund contributions a potential source of cheap loans for the employer. If the implementing regulations do not specify stiff penalties for late payment of employer contributions, the DGSE should do so.**
- #24. The DGSE should not require uniform benefits to be offered by all SOEs. Standard principles and guidelines regarding benefit levels, such as those proposed in this report, should be established, but a uniform benefit plan for all SOEs would not be appropriate given the varying industries, types of workers, and needs of different SOEs.**
- #25. SOE pension programs should seek to strike a balance between very low and excessive levels of benefits. While benefit levels that are too low can hinder the retention of desirable employees, excessive benefits lead to excessive costs and will not help to attract these workers. The DGSE should provide broad guidelines and advice or assistance to SOEs in determining appropriate benefit levels.**
- #26. The DGSE should encourage SOE pension funds to provide protection against inflation for benefits paid to participants.**
- #27. The DGSE should require SOEs to link pension fund benefits to the benefits provided by the national social security system. Formulas could be devised that would allow pension fund benefits to be increased or decreased, depending on the level of social security benefits to be provided.**

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- #28. SOE pension programs should exercise care in establishing provisions for recognizing prior years of service. When an SOE offers a new pension plan, recognition of past service should only be offered to employees if the SOE concludes, after careful actuarial calculations, that adequate funds are available to finance the additional liabilities. SOEs should be required to seek DGSE approval for such decisions.**
- #29. The DGSE should encourage and assist SOE pension funds in applying the principle of portability, as it is described in Article 26 (2) of the Pension Funds Law. The DGSE should allow SOE pension funds flexibility in implementing portability requirements, which, although they create an additional administrative cost for pension funds, are needed to encourage job mobility. Portability would also allow the Government greater flexibility in restructuring less profitable and less competitive SOEs in an increasingly dynamic economic context.**
- #30. SOE pension funds must exercise great care in moving from the current system, which provides benefits as a lump sum, to the system prescribed in the new law, under which pension benefits will be provided in monthly installments. This type of shift can be very difficult and should be carefully planned.**

Transparency and Disclosure:

- #31. The DGSE should impose minimum requirements for disclosure to SOE pension fund participants. The DGSE should specify minimum levels and types of information, including descriptions of the pension plan and its performance, that must be provided to employees.**

Investment Management:

- #32. The DGSE should require SOE pension funds to use external, professional investment management services, making exceptions on a case-by-case basis only. The DGSE should permit in-house investment management only if an SOE is able to demonstrate that it has well-defined investment policies and objectives, a clear investment process, professional expertise in all target markets, measures to promote creativity, and adequate employee compensation schemes associated with goals and productivity.**

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- #33. The DGSE should establish clear investment constraints for SOE pension funds, covering issues such as individual assets, conflicts of interest, allowable markets, and requirements for brokers.
- #34. The DGSE should require SOE pension funds to establish written investment objectives and policies. An investment policy is a statement of the founding company's preferences on a variety of issues, such as purpose, risk level, asset mix, and performance targets of a pension fund; it provides the guidelines and procedures that shape the management of the fund's assets and encourages and facilitates long-term planning.
- #35. The DGSE should require SOE pension funds to follow rigorous procedures when selecting external investment managers, favoring investment managers with domestic and international experience. Agreements should be drawn up with selected investment managers that specify in detail the duties and responsibilities of the investment manager, the quality of service that must be provided, the requirements for reporting to the founder, etc. These agreements can be used to ensure that investment managers follow the investment policies of the SOE pension funds.

c) Reporting Recommendations

- #36. The DGSE should require each SOE pension fund to provide, on a regular and ongoing basis, aggregate and detailed information on a wide range of topics. The DGSE should receive, either via the Department of Pension Funds or directly from SOE pension funds: information on any general decisions or changes that will affect the assets or liabilities of the pension fund, general management reports, reports on actuarial methodologies and valuations, financial statements, audit reports, funding performance reports, contribution and benefit information, and investment performance and transaction information.
- #37. The Directorate General should prepare standardized formats for the various reports (actuarial, audit, investment, etc.) to be submitted by SOE pension funds. These standardized formats would provide the DGSE with data to be fed into pension fund-specific information modules that would form an integral part of a broader, DGSE-wide management information system.

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- #38. **Methods to value and rank different pension programs should be established which would allow the DGSE to compare the performance of and costs incurred by different pension funds and investment managers. This type of ranking and valuation would encourage efficiency and cost effectiveness at SOE pension funds and would be a useful supervisory tool for the DGSE.**
- #39. **Periodic reports on SOE pension fund performance should be prepared by the DGSE and submitted to the Minister of Finance, in accordance with its overall reporting responsibilities. These reports should contain aggregate and summary information on all SOE pension funds and should provide comparative figures on benefits, costs, and investment performance. These reports should disclose the ranking and comparisons resulting from the process recommended above.**

d) Recommendations for Small SOEs and Financially Weak SOEs

Small SOEs and financially weak SOEs have special pension fund needs. The recommendations contained in this section deal with the needs and requirements of these types of funds.

- #40. **The DGSE should carefully assess the capacity of small SOEs and financially weak SOEs to operate individual pension funds. Individual pension funds, especially defined benefit plans, impose a degree of financial risk which may not be appropriate for these companies. The DGSE could make decisions on whether or not to allow these SOEs to operate individual pension funds on a case-by-case basis.**
- #41. **Small SOEs and financially weak SOEs should seriously consider joining together as co-founders in multiple-employer EPFs, if the DGSE determines that this is a practical and cost-effective option. SOEs that do not yet have pension funds should also be encouraged to join multiple-employer funds, which might also be used to provide pension benefits for non-staff workers of companies that already offer pension programs for permanent workers.**
- #42. **Consideration should also be given to the possibility of enrolling the employees of small SOEs and financially weak SOEs in Financial Institution Pension Funds.**

e) *Human Resource Development and Training Recommendations*

- #43. The DGSE should recruit and/or train a specialized staff to monitor and provide guidance to SOE pension funds. This staff should be composed of an actuary, an accountant, an investment specialist and a lawyer specialized in pension law. This staff would be responsible for obtaining and analyzing all information provided to the Directorate General by SOE pension funds and, if required, should be available to actively assist SOEs in creating or adapting their pension funds.
- #44. The DGSE should encourage and assist SOEs to design and implement pension-related training and human resource development programs. The DGSE should assist SOEs in developing strategies to ensure that SOE personnel have adequate skills and training to manage or oversee pension programs.
- #45. The DGSE should establish guidelines for SOE policies vis-a-vis personnel responsible for pension funds. These guidelines should be aimed at ensuring that the SOE personnel responsible for pension funds are high-quality and well-trained. Adequate compensation, which is necessary to attract qualified professionals, should also be a goal; a system of performance-linked incentives could be implemented.

D. Implementation Plan

The last chapter of the report contains a plan for implementing the recommendations contained in the previous chapter.

- This implementation plan is intended to provide the Directorate General with a strategy and program for regulating and supervising SOE pension funds. The goal of this implementation plan is to provide a structured approach that would allow the DGSE to:
 - Ensure that SOE pension funds conform to the new Pension Funds Law.
 - Regulate SOE pension funds by developing and implementing a structured set of operating instructions.
 - Monitor and supervise SOE pension funds by developing and implementing comprehensive reporting requirements.

- The implementation plan is divided into five phases and various sub-phases, as follows:

PHASE I: Start-Up: Definition of Objectives and Strategy

- This is a planning stage during which the Directorate General would clearly define its objectives and strategy with regard to regulation and supervision of SOE pension funds, and would determine the appropriate means to be used to achieve the objectives and strategy.

PHASE II: Issuance of Guidelines on Conformance with the New Pension Funds Law

- During this phase, the DGSE would issue clear guidelines to all SOE pension funds regarding adaptation to the new Pension Funds Law. The SOE pension funds would be responsible for informing themselves of all requirements of the new law and its implementing regulations and ensuring that full compliance is achieved by the deadline.

PHASE III: Development and Implementation of DGSE Instructions to SOE Pension Funds

- SOE pension funds, in addition to being required to conform to the new law and the implementing regulations, should be required to adhere to a set of implementing instructions issued by the DGSE in its role as the representative of the owner of the SOEs. These instructions, which would be developed and implemented during this phase, would be instrumental in enabling the DGSE to achieve its regulatory and supervisory objectives.

PHASE IV: Development and Implementation of DGSE Instructions for Small SOEs and Financially Weak SOEs

- Small SOEs and financially weak SOEs should seriously consider alternatives to operating individual pension funds. Given the special needs of these funds, the DGSE should deal with them separately when devising its regulatory/supervisory program, which would be done in this phase.

PHASE V: Human Resource Development and Training

- Development of a strong regulatory and supervisory system for SOE pension funds and efficient operation of that system by the Directorate General will require a comprehensive, targeted human resource development program for both DGSE staff and staff at SOEs responsible for pension programs. This would be carried out during this phase.

Chapter IV of the main report contains a step-by-step program of action for each phase.

I. INTRODUCTION

A. Background

Prior to 1992, no comprehensive set of regulations governing pension fund operations existed in Indonesia. Pension programs to date have been established and operated based on the *Arbeiderdonsen Ordonnantie*, a civil code dating from 1926, and on clauses in other laws which apply to pension funds, such as one which grants tax advantages to pension funds following a specific legal structure (*yayasan dana pensiun*).

A new Law Concerning Pension Funds, Law No. 11/1992 dated April 20, 1992, provides a basic legal structure and guidelines for pension funds. Within these basic guidelines, pension funds will have a wide degree of choice regarding structure, management, and operations. All existing pension funds, including SOE pension funds, must make a decision regarding adaptation to this law. Pension funds who choose to do so must adapt to this law by April 20, 1993, one year after the date of promulgation.

A new social security system has also recently been enacted, based on Law No. 3/1992 on Workers' Social Security, which will have an impact on pension funds. Social security contribution and benefit levels will be stipulated in the implementing regulations in support of this law. Although these regulations have not yet been issued, it is assumed that they will specify a minimum level of benefits to workers, leaving room for a voluntary pension system which would provide additional benefits. A very high level of contributions (significantly higher than the current level of approximately 6% of employees' salary) to the social security system could limit, perhaps quite seriously, the growth of pension funds. This report and the recommendations contained therein are based on the assumption that the social security system will provide only basic benefits and that there will be room for an additional pension system, as envisioned in the new Pension Funds Law.

The Directorate General of State Enterprises (DGSE)¹ is the unit within the Ministry of Finance (MOF) responsible for formulating policies for and monitoring the performance of state-owned enterprises (SOEs), including the design and operation of pension funds. To date, more than 185 SOEs have organized pension plans for their employees. Given the lack of a comprehensive set of regulations governing pension funds, however, these companies follow a wide variety of pension arrangements and are not closely supervised by the DGSE.

¹ *The bulk of the activities upon which this report is based were carried out before the change of status from Directorate to Directorate General. However, for convenience of exposition, the client organization will be referred to throughout the report as the Directorate General of State Enterprises.*

The existing SOE pension plans will now have to make a decision regarding adaptation to the new Pension Funds Law. They must make this decision, and adapt to the law if they choose to do so, prior to April 1993.

SOE pension funds represent a fiduciary obligation of great magnitude on the one hand, and a very large pool of investable funds on the other. To fulfill its responsibilities, the Directorate General will need to consider formulating coherent policies and setting guidelines that will allow it to regulate and supervise the design and operation of SOE pension funds in an appropriate fashion.

B. Objective and Scope

This report corresponds to task 2.5 of the FMP SOE Restructuring and Privatization Component First-Year Workplan. The objective of this task is to assist the DGSE to undertake an assessment of the pension arrangements of SOEs and to make recommendations on operational guidelines to be established by the Directorate General, taking into account the options created by the new Pension Funds Law, to assure efficient and responsible management of SOE pension funds.

The purpose of this report is limited to recommending broad guidelines which should shape the detailed instructions to be issued by the DGSE. These guidelines are intended to:

- Provide a structured set of standards, operating procedures, and reporting requirements within which SOE pension funds must operate.
- Facilitate monitoring and supervision of SOE pension funds by the DGSE.

The report includes a recommended implementation plan, which lays out a systematic approach for further development and implementation of the DGSE guidelines and instructions.

C. Methodology

This task was carried out by Alberto Libedinsky, a pension funds specialist, and Deborah Dungan of Price Waterhouse's Office of Government Services in Washington, D.C., working closely with the staff of the Directorate General of State Enterprises. William Hollinger, FMP Senior Privatization Specialist, and Mark Camstra, FMP Chief of Party, provided technical and managerial oversight.

As a first step, information on the legal and regulatory aspects of pension funds and other related issues, including the social security system, was analyzed. A series of meetings was held with MOF officials from the Directorate General of State Enterprises and the Directorate of Pension Funds (formerly the Subdirector of Insurance and Pension Funds) to better understand the concepts behind the new Pension Funds Law and the upcoming implementing regulations. Drafts of the implementing regulations were not available for review. Although some general ideas about the probable content of the regulations were shared with this team, the unavailability of these regulations was a constraint in the preparation of this report.

Meetings were held with a representative sample of SOE and SOE pension fund officials. Meetings were also conducted with experts in the life insurance business who have pension-related businesses, and with capital market officials and institutions.

Appendix A contains a list of people interviewed for this assignment, and Appendix B contains a list of background documents gathered.

D. Contents of the Report

Chapter II presents the key findings and conclusions of the team carrying out this assignment. These findings and conclusions are divided into two broad categories: 1) the new legal environment and its impact on SOE pension funds, and 2) current operations and practices of SOE pension funds.

Chapter III contains recommendations based on the findings and conclusions discussed in Chapter II of this report. A few broad recommendations concerning the general pension fund environment in Indonesia are presented, aimed at the MOF broadly and at the Department of Pension Funds specifically. Most of the recommendations, however, are directed at the Directorate General of State Enterprises and are intended to provide guidance in the process of developing a system to regulate and supervise the pension funds of state-owned enterprises. The DGSE recommendations are divided into the following categories:

- Strategic Recommendations
- Operational Recommendations
- Reporting Recommendations
- Recommendations for Small and Financially Weak SOEs
- Human Resource Development and Training Recommendations

Chapter IV contains a plan for implementing the recommendations contained in the previous chapter. This implementation plan is intended to provide the Directorate General with a strategy and program for regulating and supervising SOE pension funds. The implementation plan is divided into five phases:

- PHASE I Start-Up: Definition of Objectives and Strategy**
- PHASE II Issuance of Guidelines on Conformance with the New Pension Funds Law**
- PHASE III Development and Implementation of DGSE Instructions to SOE Pension Funds**
- PHASE IV Development and Implementation of Instructions for Small SOEs and Financially Weak SOEs**
- PHASE V Human Resource Development and Training**

II. KEY FINDINGS AND CONCLUSIONS

This chapter presents the key findings and conclusions of the team carrying out this assignment. These findings and conclusions are divided into two broad categories: 1) the new legal environment and its impact on SOE pension funds, and 2) current operations and practices of SOE pension funds.

A. The New Legal Environment and its Impact on SOE Pension Funds

It appears likely that domestic operations of financial institutions will become increasingly sophisticated and increasingly active in the capital market. The new legal environment which is being defined will, when implemented, encourage competition and transformation of financial and investment activities.

Pension funds, as major institutional investors, should play a vital role in this process. The evolution of pension funds in the coming years will be shaped not only by the new Pension Funds Law and its implementing regulations, but also by other laws and decrees -- on social security, insurance, capital markets and banking -- which have recently been promulgated. The provisions contained in these new laws and decrees, therefore, must be taken into account by the Directorate General of State Enterprises as it develops guidelines for SOE pension funds. Given this, an understanding of the new legal framework is critical in carrying out this assignment.

The main purpose of the following analysis of different laws and decrees is to identify the main components of each law or decree as they relate to the establishment and operation of SOE pension funds.

1. The Pension Funds Law

a) Objectives and Basic Principles

The objective of the new Pension Funds Law is to establish a comprehensive legal structure for the operation, management, supervision and control of pension funds. The initiative for establishing a new law on pensions came from the Government. Prior to the promulgation of the new law, the MOF had very little regulatory or supervisory authority over pension funds.

The law is a solid framework which allows a variety of pension agreements and a wide degree of choice and flexibility to companies in designing benefit plans. The law, which includes provisions governing the rights and obligations of both employers and employees, is based on the following basic principles:

1. Pension fund assets must be separate from those of the founding company or companies (known as the "founder" or "founders").
2. The assets of a pension fund can only be used to provide benefits for the fund's participants.
3. Pension programs must accumulate a sufficient level of funds to fulfill the rights of the participants. Pension funds should be fully funded.
4. Accumulation of funds by a pension plan is intended to guarantee the right of participants to receive a continuous stream of income upon retirement. Payment of retirement benefits will be made primarily on a periodic, rather than lump-sum, basis.
5. The pension system is voluntary. Each company (employer) must decide, based on its financial capabilities, whether or not to offer pension benefits to its employees.
6. Pension funds established in conformance with the new law are eligible for certain tax exemptions. Contributions to pension funds by both employers and employees are deductible expenses, as is income from pension fund investments in time deposits, CDs, savings accounts and listed stocks and bonds. (Pension fund investments in real estate, foreign instruments, and other types of investments are not deductible).

b) Implementing Regulations

Implementing regulations to support the law will be issued at two levels -- Governmental (issued by the President) and Ministerial (issued by the Minister of Finance). These regulations are expected to provide, in detail, specific requirements for pension funds. They will to a large extent shape the future pension system in Indonesia. To date, neither set of regulations has been issued, although the process of drafting the Governmental regulations is nearly complete and the process of drafting the Ministerial regulations is underway.

The implementing regulations will be prepared and submitted to the Government and to the Minister of Finance for review and approval by the Directorate of Pension Funds (DPF) of the Ministry of Finance (MOF), formerly known as the Subdirectorate of Insurance and Pension Funds.

c) *Legal Status of Pension Funds*

Pension funds organized in conformance with the new law will have a clear legal status. Under the *yayasan* form that is currently widely used by pension funds in Indonesia, many relevant aspects of the legal structure are not clearly defined. For instance, it is unclear whether accumulated resources belong to the founder or to participants. The legal commitment of a founder to provide the promised benefits under this type of structure is also ambiguous. The new law establishes that pension funds will "have the status of statutory bodies under the requirements and procedures as stipulated in this law." (Article 2)

Article 4 of the Pension Funds Law states that any party implementing a program promising sums of money to be paid upon reaching a certain age must register with the MOF on the basis of this law, unless the said program is based on a separate law. This implies that *an entity which has or wishes to establish a pension program must register with the MOF and conform to the new Pension Funds Law unless it can base its pension program on another law.* In the case of a pension fund established by a company, the only alternative to conforming to the Pension Funds Law is conforming to the new Insurance Law. It is possible for a company to enroll its employees in a group pension plan offered by an insurance company, in accordance with the Insurance Law, in which case the pension program need not be registered with the MOF. It should be noted, however, that no tax exemptions will be granted to such pension funds, and (from the point of view of both the employee and the employer) there will be a lack of government supervision.

All existing pension funds which had been approved by the MOF prior to the promulgation of the new law will be considered to have been approved under the terms of this law. These funds, should they wish to remain registered, must make adjustments to ensure that they conform to the provisions of the law by April 1993. A longer period--up to five years--will be allowed for pension funds to adjust the management of their investment portfolios to conform with the new law.

Many employers, including some SOEs, are currently operating pension funds that have not been approved by the MOF. Unless these funds comply or will comply with the Insurance Law provisions governing group pension programs, as explained above, they are required to submit applications to the MOF within a one-year period, before April 1993.

d) Types and Structures of Pension Funds

Two basic types of pension funds are permitted under the new Pension Funds Law:

- 1) **Employers' pension funds (EPFs)**, established by one or more employers, or founders. EPFs may be either defined benefit or defined contribution programs.
- 2) **Financial Institution Pension Funds (FIPFs)**, established by banks or life insurance companies. FIPFs can only be defined contribution programs.²

It is important to understand the difference between defined benefit (DB) and defined contribution (DC) pension programs:

- **Defined benefit pension programs** are those under which the pension fund provides a pre-determined benefit, usually related to an employee's length of service and/or pay. In defined benefit pension programs, formulas must be included in the by-laws that determine the amount of the benefits to be provided. Contributions are adjusted as necessary to meet the determined benefit levels. Typically, the employee contributes a fixed amount; additional contributions needed to meet the pre-determined benefit levels come from the employer.

Defined benefit (DB) plans are more common than defined contribution (DC) plans, in Indonesia and in other countries, both developed and developing.

- **Defined contribution pension programs** are those in which the contribution levels are determined in the by-laws of the pension fund. The contributions made by and on behalf of each participant, and the returns obtained on those contributions, are recorded in the individual account of each participant. The benefits received are variable, depending on several factors, including the level of contributions, investment earnings, and age upon retirement.

² FIPFs may be similar in some respects to IRAs in the United States, but are very different in others. In the U.S., many employers are utilizing or sponsoring individual retirement savings plans instead of qualified plans because of their simplicity. Eligibility, funding, distribution, and other aspects are also different.

According to the new law, all defined contribution pension funds (both EPFs and FIPFs) must use accumulated funds to purchase an annuity from a life insurance company.

The law permits employers to establish profit-sharing pension funds. These funds must be defined contribution funds, with contributions coming only from the employer, based on formulas connected to the profits of the employer. Profit-sharing plans do not impose a fixed commitment on employers and will allow companies to connect productivity with pension benefits, thereby offering employees an incentive to perform more efficiently.

Within the framework described above, a company (including an SOE) can choose for some or all of its employees to:

- 1) create its own pension fund (as a founder), which can be either a defined benefit or a defined contribution program,
- 2) join (as a co-founder) a pension fund established by another employer, which can also be a defined benefit or defined contribution program, or
- 3) enroll its employees in a financial institution pension fund, which must be a defined contribution program.

Existing pension funds will be allowed to merge or to separate into two or more funds. Government regulations will establish policies and procedures for mergers and separations.

e) Benefits, Contributions, and Participants' Rights

Contributions to EPFs may be made by both employers and employees, or may be made by employers only, with no employee contributions. The contributions of employers must be made at least monthly and must be paid into the pension fund, except in the case of profit-sharing plans. Contributions to profit-sharing plans must be paid no later than 120 days after the end of the company's fiscal year. Further provisions on contributions, late payments and other related issues will be stipulated in the Government regulations.

In the case of defined benefit pension programs, MOF regulations will stipulate maximum contribution levels for both total contributions and employees' contributions, maximum benefit levels and asset requirements. These regulations, which will be in line with tax provisions, will be aimed at avoiding excessive exemptions.

Employees who fulfill the requirements established by an employer for an EPF are entitled to become participants in the fund, as long as they have either reached the age of 18 or are married and have worked for the founder or co-founder for at least one year. In pension funds with all contributions coming from the employer, all employees who fulfill participation requirements must receive equal treatment. If a pension fund requires employees to pay contributions to a pension fund, employees have the right to choose not to participate.

Pension fund participants are entitled to the following benefits:

- **Normal retirement pensions:** Paid at or after the time a participant reaches "normal retirement age." The Pensions Law specifies that the designated normal retirement age must be stipulated in the by-laws of the fund, but cannot exceed the normal retirement age determined by the Minister of Manpower for these purposes.
- **Deferred pensions:** The right to pension benefits for a participant who stops working for the founding employer before reaching normal retirement age. In this case, payment of benefits is deferred until the participant is pensioned according to the by-laws of the fund.
- **Accelerated pensions:** Paid after a participant reaches a certain age, which must be at least 10 years prior to the specified "normal retirement age". The law stipulates that the value of an accelerated pension must be in all cases at least equal to the value of a deferred pension.
- **Disability pensions:** Paid in the case of a participant who becomes disabled.

According to the law, pension funds will also contain provisions regarding death benefits (pensions for the widows or widowers and the underage children of participants).

Vested benefits to employees may not be reduced by changes in the internal by-laws of a pension fund.

Exhibit I compares the benefits to be provided by defined benefit pension programs and defined contribution programs, according to the provisions of the new law.

COMPARISON OF BENEFITS PROVIDED BY DB vs. DC PENSION FUNDS
DEFINED BENEFIT PENSION FUND

	<i>Death Benefit</i>	<i>Employment Termination Benefit</i>	<i>Disability Benefit</i>
<u>Initial Period</u>	Widow/widower receives accumulation of contributions of participant plus interest as lump sum	Participant receives accumulation of his/her contributions plus interest as lump sum	Participant receives accelerated pension
<u>Middle Period</u>	Widow/widower receives at least 60% of deferred pension or lump sum	Participant is entitled to a deferred pension or to transfer pension rights to another fund	Participant receives accelerated pension
<u>Early Retirement (Accelerated) Period</u>	Widow/widower receives at least 60% of accelerated pension	Participant is entitled to an accelerated pension.	Participant receives accelerated pension
<u>Normal Pension Period</u>	Widow/widower receives at least 60% of normal pension	Participant is entitled to a normal pension	Participant receives a normal pension

Definitions:

The "initial period" is defined as the first three years of participation in the pension fund.

The "middle period" is after the first 3 years of participation and more than 10 years before normal retirement age.

The "early retirement period" is the last ten years prior to retirement age.

The "normal pension period" is after the participant reaches the normal retirement age.

COMPARISON OF BENEFITS PROVIDED BY DB vs. DC PENSION FUNDS

DEFINED CONTRIBUTION PENSION FUND

	<i>Death Benefit</i>	<i>Employment Termination Benefit</i>	<i>Disability Benefit</i>
Initial Period	Widow/widower receives accumulation of contributions of participant plus interest as lump sum	Participant receives accumulation of his/her contributions plus interest as lump sum	Participant receives accelerated pension
Middle Period	Widow/widower receives at least 100% of deferred pension or lump sum	Participant is entitled to a deferred pension, considering own and employer's contributions plus return, or may transfer rights to another fund	Participant receives accelerated pension
Early Retirement (Accelerated) Period	Widow/er of pensioner receives according to annuity specification. Widow/er of active participant receives at least 100% of deferred pension.*	Participant is entitled to an accelerated pension	Participant receives accelerated pension
Normal Pension Period	Widow/widower receives according to annuity specification.	Participant is entitled to a normal pension	Participant receives a normal pension

Definitions:

The "initial period" is defined as the first three years of participation in the pension fund.

The "middle period" is after the first 3 years of participation and more than 10 years before normal retirement age.

The "early retirement period" is the last ten years prior to retirement age.

The "normal pension period" is after the participant reaches the normal retirement age.

*It is unclear why the Pension Funds Law does not use 100% of accelerated pension as a reference for this benefit.

The new law requires that benefits be paid on a monthly basis, rather than as a lump sum, although a maximum of 20% of pension benefits can be provided as a lump sum. Many existing pension funds, including many SOE pension funds, currently have programs which only offer lump-sum payments upon retirement. These funds will be allowed to continue to provide lump-sum benefits until all obligations have been met to employees who were pension fund participants at or prior to the time the law was promulgated.

Detailed provisions on benefits and on the rights of participants will be made in Government regulations.

f) Management of Pension Funds

The founder of an Employer's Pension Fund can appoint an individual or a company as the pension manager. The tasks, obligations and responsibilities of a pension manager, as well as the procedures for appointment and replacement of the manager, will be further stipulated in the upcoming Government regulations.

Pension fund management can effectively be divided into two separate tasks -- management of operations and administration and management of investments. For the purpose of clarity in this report, the first of these tasks will be referred to as "pension management" and the second as "investment management."

An EPF is permitted to enter into contracts with third parties regarding both investment management by licensed investment managers and pension management. Pension management agreements typically provide operational as well as technical services, such as registering individual employee accounts and employer accounts, calculating contributions, calculating and paying benefits, making actuarial calculations of reserves, preparing actuarial reports, designing products and providing legal support.

In the case of Financial Institution Pension Funds, Article 43 specifies that the founding financial institution will handle both pension management and investment management.

The Board of Supervisors of an EPF will include representatives of the employer and of the participants (both active employees and pensioners) in equal numbers. Members of the Board will be appointed by the founder; their role will be to supervise the pension manager and submit annual written reports regarding this supervision to the founder. Copies of these reports must be made available to participants. Additional tasks, obligations and responsibilities of the Board, as well as procedures for the appointment and replacement of members, will be stipulated in the Government implementing regulations.

The law stipulates that pension funds' annual financial statements must be audited by public accountants.

g) Pension Fund Assets and Management of Investments

The sole purpose of the assets of a pension fund is to enable the fund to fulfill its pension obligations to participants. Assets must be maintained at the same level as the pension fund's actuarial liabilities. Excess assets beyond a certain limit (to be established by the MOF) may be calculated as employer's contributions to the pension fund, but may not then be paid back to the employer.

With regard to investment management, the manager of a pension fund must act in accordance with the investment direction provided by the founder and the Board of Supervisors. Investment management practices must conform to provisions stipulated by the MOF, which include protection against practices involving conflicts of interest, and to the Capital Market Decrees. Agreements may be made with third parties who are licensed investment managers (in conformance with the Capital Markets Decree) to provide either investment advisory services only, or a full range of investment management services. Safeguarding of assets as specified in the Pension Funds Law refers to custodial services, which must be contracted with banks or other authorized entities.

The management of assets and pension funds' investments will be supervised by the MOF. Detailed provisions on these topics will be contained in the Ministerial implementing regulations in support of the new Pension Funds Law.

2. The Social Security Law

a) General Provisions of the Law

On February 17, 1992 Law No. 3/1992 on Workers' Social Security was approved by Parliament. This law complements the new Pension Funds Law; together the two laws constitute clear and modern Government policies on social insurance benefits.

As in the case of the Pension Funds Law, implementing regulations in support of the Social Security Law will be issued in the near future. These regulations, when known, may have an impact on pension programs established by companies, including SOEs.

The Social Security Law prescribes mandatory participation by all employers in a social security system that provides basic benefits. The status of self-employed workers under the new Social Security Law is unclear, but is expected to be clarified and further regulated in the implementing regulations.

The result of the Social Security and Pension Funds Laws will be a two-tier system:

- All employers with 15 or more employees will participate in the compulsory national social security system, which will be administered by a state-owned company under the control of the Government.
- An employer can choose to complement the benefits offered by the social security system by establishing or participating in an additional pension program for all or part of its employees.

b) Implications for SOE Pension Funds

Contribution levels and procedures and benefit levels will be stipulated in the implementing regulations in support of the Social Security Law. Although these regulations have not yet been issued, it is assumed that they will specify a minimum level of benefits to workers, leaving room for a voluntary pension system which would provide additional benefits. A very high level of contributions (significantly higher than the current level of approximately 6% of employees' salary) to the social security system could limit, perhaps quite seriously, the growth of pension funds. This report and the recommendations contained therein are based on the assumption that the social security system will provide only basic benefits and that there will be room for an additional pension system, as envisioned in the new Pension Funds Law.

The social security system provides four basic types of benefits: retirement benefits, death benefits, occupational accident benefits, and health benefits. Pension plans will offer both retirement and death benefits to complement the benefits provided by the social security system, but are not allowed to offer occupational accident benefits and health benefits. The Social Security Law stipulates that:

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- Retirement benefits will be paid when the worker reaches the age of 55 or is permanently disabled. These benefits may be paid either as a lump-sum or periodically, or a combination of the two. Accelerated pensions may be paid before the worker reaches the age of 55, provided that a certain period of participation in the social security program has been completed. Contributions toward retirement benefits are to be paid by both employers and employees.
 - Death benefits will be paid to the widow or widower and/or the children of a worker who dies from a cause other than an occupational accident. These benefits include burial costs and other monetary compensation. Contributions toward death benefits are to be paid by the employer only.

3. Insurance Law

a) *General Provisions of the Law*

On February 11, 1992 the Parliament passed Law No. 2/1992 on Insurance Business which provides a framework and a system of control for the insurance industry. The law defines four types of insurance business: 1) general or loss insurance, 2) life insurance, 3) social insurance, and 4) reinsurance. Specialized companies must be established, each of which can only conduct specific types of activities:

- A general insurance company can only engage in general loss insurance business, including reinsurance in this sector.
- A life insurance company can only conduct life insurance, health insurance, accident insurance and annuity businesses. A life insurance company can also become the founder and administrator of a Financial Institution Pension Fund, in accordance with the new Pension Funds Law.
- A reinsurance company can only conduct reinsurance business.
- A social insurance company (such as ASTEK or TASPEN) can only conduct social insurance business. The existence of social insurance companies, which will implement the social security system as prescribed in the Social Security Law, is mandatory. They must be Government-owned companies and must conform to the new Insurance Law.

The Insurance Law also defines various insurance industry supporting businesses, such as law firms, accounting firms and actuarial consulting companies. Actuarial consulting companies provide a number of services, including actuarial consultation services, consultations on analysis and calculation of reserves, preparation of actuarial reports, appraisal of risks, and design of life insurance products. The services provided by actuarial consulting companies are primarily related to the formation and management of insurance programs and pension programs.

b) Implications for SOE Pension Funds

According to the new Insurance Law, the following kinds of relationships might occur between insurance companies or insurance industry supporting businesses and SOE pension funds:

- An SOE could enroll some or all of its employees in a Financial Institution Pension Fund founded and administered by a life insurance company.
- An SOE could enroll some or all of its employees in a group pension plan offered by a life insurance company. This type of arrangement, which would be based on the Insurance Law, would not allow any tax exemptions as it would not be in conformance with the Pension Funds Law.
- An SOE pension fund could enter into an agreement with a life insurance company to provide pension management services. Such an agreement, however, could not include provision of investment management services, as investment management services must be provided by licensed investment managers. According to the Insurance Law and the Capital Market Decrees, life insurance companies are not allowed to become investment managers. An SOE pension fund could also enter into service agreements with insurance industry supporting businesses, such as actuarial consulting companies, accountants and attorneys.

4. Capital Market Decrees

a) *General Provisions of the Decrees*

New decrees governing the capital market were promulgated in December 1990: Presidential Decree No. 53/1990 and Ministerial Decree No. 1548/KMK.013/1990. Amended in November 1991 by Ministerial Decree No. 1199/KMK.010/1991, the Capital Market Decrees (CMDs) establish a broad regulatory framework for a fair, efficient and orderly capital market, based on the principle of private sector self-regulation, with supervision and approval of self regulatory rules by BAPEPAM.

The CMDs stipulate that securities companies may serve as underwriters, broker-dealers, investment managers and investment advisors, provided they have received an appropriate license for each activity from BAPEPAM.

The CMDs specify that "*Investment manager* means a person who carries on a business of managing a portfolio of securities for a client or a collective investment portfolio for a group of clients." Exceptions to this definition are insurance companies, pension funds or banks, who--when carrying out investment management activities as part of their normal business--are not considered *investment managers*. A licensed investment manager can also act as an investment advisor.

The CMDs specify that "*Investment advisor* means a person whose business activities include giving advice, making analysis and reports on securities (other than exempt securities) to at least fifteen other persons." Underwriters, broker-dealers and any other persons whose investment advisory activities are conducted solely in connection with their business activities and who do not receive any specific compensation for their investment advisory activities are not considered *investment advisors*.

b) *Implications for SOE pension funds*

The following types of agreements could be formed between securities companies as regulated under the Capital Market Decrees and SOE pension funds:

- An SOE pension fund could enter into an agreement for the provision of investment management and investment advisory services with a securities company that is licensed to serve as an investment manager.

- An SOE pension fund could enter into an agreement for the provision of investment advisory services only with a securities company that is licensed to serve as an investment advisor.

5. Banking Law

a) *General Provisions of the Law*

In February 1992 Law No. 7/1992 on Banking was promulgated, which defines two main types of banks--general banks and people's credit banks, both of which are supervised by Bank Indonesia.

The main business of general banks includes: taking deposits; providing credits; issuing debt instruments; buying, selling or guaranteeing short-term securities; transferring money; borrowing and lending funds to other banks; providing facilities for storage of goods and securities; placing funds for third parties; conducting factoring activities; engaging in credit card business and trust agent activities; providing financing on a profit-sharing basis; and acting as custodians. General banks may also conduct foreign exchange transactions; invest in banks or other financial enterprises, such as leasing, venture capital, securities companies, insurance, and clearing, settlement and depository institutions; engage in temporary capital participation; and *act as founders and administrators of pension funds*.

People's credit banks are not permitted to engage in money market activities (money market instruments are those with a maturity of less than one year). They may engage in a limited range of activities, which includes: receiving deposits other than demand deposits; providing loans and equity finance for customers based on profit sharing principles; and placing funds in other banks. They are not permitted to participate in the traffic of payments, foreign exchange activities, capital participation or insurance business.

b) *Implications for SOE Pension Funds*

All EPFs, including those established by SOEs, must enter into a custodial contract with a bank or other authorized entity, the purpose of which is to safeguard and hold financial assets in custody. In addition, the following types of relationships can be established between banks or their related financial institutions and SOE pension funds:

- An SOE could enroll some or all of its employees in an Financial Institution Pension Fund (FIPF) founded and administered by a bank.

- An SOE pension fund could enter into an investment management contract with a securities company related to a bank which is licensed to serve as an investment manager.

B. Current Operations and Practices of SOE Pension Funds

To date, the scope and role of pension funds in Indonesia has not been large, as few companies or individuals outside of the Government have chosen to participate in a pension program. The impact of pension funds in the domestic financial sector has been minor, and investment supervision and guidance by Government authorities has been loose.

Despite their limited scope in Indonesia in general, however, pension funds are widely used by SOEs as part of their total benefits package -- virtually all SOEs currently have some type of pension program. The scope of these SOE pension funds is very large: as of the end of 1991, total assets of more than three trillion Rupiah (approximately US\$1.5 billion) had been accumulated by SOE pension programs (as shown in Exhibit II).

A general overview of SOE pension fund operations and practices is contained in this section of the report. In the case of most of these funds, major changes in structure, governance, management, funding and investment practices, and benefit provisions will be needed as they go through the process of adapting to the new Pension Funds Law.

1. Current Legal Structures

Because there are no specific regulations governing SOE pension funds, they currently exist in a wide variety of forms. The most common forms are described below:

- Yayasan Dana Pensiun: Ninety-one SOEs have organized their pension funds in the form of a *yayasan dana pensiun*.³ *Yayasan dana pensiun* (hereafter referred to simply as "yayasans") are specifically organized to provide pension and other benefits to employees. The *yayasan* structure carries advantages for companies who take advantage of it, provided the *yayasan* is registered with the MOF. The most important of these advantages is tax deductions for employer and employee contributions, and for income received from certain

³ *Yayasans (foundations) are legal entities based on the old civil code dating from 1926. The yayasan structure can be used for a variety of types of organizations that have welfare, charity or social objectives.*

SUMMARY OF SOE PENSION FUNDS

(as of December 1991)

SECTOR	NUMBER OF COMPANIES W/ PENSIONS	PENSION MANAGEMENT					PENSION FUNDS (billion Rp)		
		YAYASAN	GOV. INSURAN.	SOE	PRIVATE INS.	NOT DECIDED	ASSETS	LIABILITIES	BALANCE
INDUSTRIAL	37	17	12	5	0	3	131	197	(66)
FINANCE	30	19	8	1	0	2	1,615	2,229	(614)
TRANSPORTATION	17	1	0	0	0	16	3	29	(26)
CONSTRUCTION	19	10	1	0	1	7	34	54	(20)
COMMERCE	8	1	2	4	1	0	305	0	305
MINING & ENERGY	6	4	1	1	0	0	613	1,184	(571)
COMMUNICATIONS	7	3	1	1	1	1	273	861	(588)
FORESTRY	4	1	2	0	0	1	2	1	1
INFORMATION	4	0	1	0	0	3	0	0	0
HEALTH	4	3	0	1	0	0	21	5	16
DEFENSE	2	0	2	0	0	0	1	0	1
EDUCATION	1	0	1	0	0	0	0	0	0
LABOR	1	0	0	0	0	1	52	0	52
AGRICULTURE	34	26	5	0	0	3	152	252	(100)
OTHER	11	6	1	1	0	3	0	87	(87)
TOTAL	185	91	37	14	3	40	3,202	4,899	(1,697)

Source: Ministry of Finance

types of investments. Requirements for registration of *yayasans* with the MOF are not comprehensive, however, and are not always strictly applied.

- **Non-registered pension programs:** Fifty-four SOEs have pension programs that are not registered with the MOF. These plans follow a variety of management arrangements, such as management by government insurance companies (e.g. PT Asuransi Jiwasraya), management by private insurance companies or – in some cases – management by the founding company. Non-registered pension funds do not receive any tax exemptions and do not require an SOE to create a complete pension organization.
- **Other forms:** The other forty SOE pension programs follow a variety of structures. A number of these companies are in a transition period, trying to transform non-registered pension funds into the *yayasan* form. Some SOEs use book reserve schemes, in which the company registers a liability in its financial statements. Other SOEs have pension plans that have no reserves, with benefits being paid as required out of the general revenues of the company.

See Exhibit II, "Summary of SOE Pension Funds" for more detailed information on current SOE pension funds.

Pension funds at SOEs have been operating concurrently with the existing social security system – Asuransi Social Tenaga Kerja, which is administered by ASTEK. Participation in this system is mandatory for all employers with more than 15 employees. The social security system provides basic workers' accident and retirement benefits, paid as a lump-sum. Contributions to ASTEK are currently set at about 6% of a worker's base salary, paid by both employers and employees (see Table 1 below). This system, organized in 1977, is undergoing major reforms following the promulgation of the new Social Security Law, as described in Chapter II, Section A.2. of this report.

TABLE 1: CURRENT CONTRIBUTIONS TO ASTEK		
Type of Benefit	Employer's Contribution *	Employee's Contribution *
Retirement	1.50%	1.00%
Accident	0.24% - 3.60% **	none
Death	0.50%	none

* Calculated from base salary only.

** Contribution depends on type of industry.

2. Contributions, Benefits and Participants' Rights

In most cases, not all employees of an SOE are eligible to participate in the company's pension fund. Employees at SOEs are typically classified as "staff" (i.e. permanent) employees, or "non-staff" (i.e. non-permanent) employees. In most cases, only permanent employees may participate in the pension fund; non-staff workers do not receive any pension benefits. Another commonly-found requirement for participation in SOE pension funds is that an employee have worked for the SOE for a certain period of time, usually one or two years. In some cases, participants are also required to be at least 18 years old or married.

Pension fund contributions are in most cases paid by both the employer and the employee. Employee contributions normally run from 3% to 10% and employer contributions from 7% to 20%, calculated on base salary only in some cases, but often calculated on base salary plus certain allowances.

An employee who stops working for an SOE prior to retirement age in order to work for another company does not, in most cases, have the right to get his/her contribution back or transfer it to the new employer's pension fund. This lack of portability does not currently appear to cause many problems, as it is not common for workers to move from one company to another. It could become a constraint on labor mobility in the future, however, as the Indonesian labor force becomes more responsive to international practices.

Virtually all, if not all, SOE pension funds are defined benefit programs. Many SOEs have modelled their pension funds on the pension program for civil servants that is administered by TASPEN, which provides benefits on both a lump-sum and an annuity basis. In most cases, SOEs do not take into consideration the benefits to be received from the social

security system when calculating benefit levels for pension fund participants.

The Government has not yet provided general guidelines on levels and types of benefits to be provided by pension funds. As a result, a wide variety of benefit arrangements exist, which in some cases (especially as they pertain to senior management) might be overly generous, while in other cases benefit levels may be quite low. Pension fund benefits are currently understood by SOEs as a means of protecting and maintaining income, rather than as a means of providing additional deferred compensation.

Benefits provided by SOE pension funds typically include the following, paid in a lump-sum and/or monthly installments:

- **Retirement benefits:** Paid when a participant reaches the normal retirement age, usually 55 or 56. Benefit levels are usually calculated using a formula based on the final salary and the number of years of service with the founding company.⁴ Benefit levels are usually capped at 60% to 75% of final salary, although in some cases yearly increases to pension benefits are made. Some funds' participants are eligible for accelerated pensions after they have reached the early retirement age, usually 10 years before the normal retirement age.
- **Death benefits:** Paid to the widow/widower or to the children if there is no widow/widower upon the death of a participant. A widow/widower usually receives up to 60% of the pension that the participant would have received. Benefits paid to orphans vary, but are generally calculated as a percentage of the amount that would have gone to the widow/widower (20% of the widow/widower's pension to each child, for example) until the child is 25 years old. In some cases death benefits are paid only as a lump-sum.
- **Disability benefits:** If provided, are paid when a participant becomes disabled. The beneficiary receives a pension based on the number of years he/she has been with the company.
- **Health and medical benefits:** Are not universally provided. When provided, they are typically subject to a monthly limit. Hospitalization plans are also sometimes provided.

⁴ A typical formula, for example, would be 2% of a participant's final salary times the number of years he/she has worked with the company. Hence, an employee who has been with a company for 30 years would receive 60% of his/her final salary as a retirement benefit, while an employee who has been with the firm for 15 years would receive 30%.

In addition to these standard benefits, additional benefits sometimes provided by SOE pension funds include education and housing. Under the new Pension Funds Law, these types of benefits will have to be provided through funding mechanisms that are separate from pension funds and pension fund assets.

3. Management of SOE Pension Funds

Most state-owned enterprise pension funds today are not managed by trained professionals. SOEs generally do not have any previous experience in establishing or managing pension programs. Management is conducted either in-house, often by the company's Personnel Department, or by an outside pension fund manager, which is usually a state-owned insurance company, although some SOEs use private insurance companies for this purpose. In either case, training, development of skills, and adequate compensation for the SOE staff responsible for managing or overseeing pension funds has not been given a high priority.⁵ In many cases, management of SOE pension funds is carried out by high-ranking retired employees of the founder, most of whom do not have expertise in pension or investment management.

SOE pension funds have not been provided by the Government with guidelines or supervision in areas such as pension technology, investment objectives and practices, conflicts of interest and general ethical considerations. Guidance or supervision in all of these areas could help SOE pension funds operate effectively. No general accounting or actuarial standards have been established. Requirements for reporting to authorities currently exist only in vague form; the MOF receives very little information regarding the performance or status of SOE pension funds. The staff at the DGSE who are responsible for monitoring and supervising SOE pension funds have yet to receive adequate training.

Independent management of SOE pension funds is not encouraged -- pension funds are generally operated as an integral part or simply as an extension of the founding company, which is actively involved in supervising or even managing the pension fund's activities. Pension funds and pension fund assets are often used to serve the general objectives of a company, rather than to serve the interests of participants, which potentially creates conflict of interest problems. This problem is often exacerbated when retired SOE executives are responsible for managing pension funds -- not only are they accustomed to reporting to the management of the SOE, but their lack of pension experience makes them dependent on advice and guidance received from the founder.

⁵ *Where pension funds are being managed by outside insurance companies, the SOE typically has a very low level of awareness about how the pension fund is managed and how its assets are invested.*

Participation by employees in the establishment and management of SOE pension plans is almost nonexistent. Participants generally have a very low level of understanding of their pension plans, as they are rarely provided with any information about its current status. This lack of protection for and awareness by participants was an important factor leading to preparation of the new Pensions Law. One of the goals of the new law is to ensure that pension fund participants are involved in the management of the fund, are adequately informed about the status of the fund, and are fully protected.

For the most part, when SOE pension funds were established, prior years of service with the company were recognized, creating sizable funding requirements. In a few instances, past service liabilities have been funded, but more frequently a large balance remains unfunded. .. In some cases, current employer contributions are also unfunded. It is not clear that unfunded liabilities on the part of the employer are recorded on the company's balance sheet in accordance with appropriate accounting standards.

A major concern of the DGSE is the fact that, at the end of each fiscal year, many SOE pension funds are faced with unexpectedly high costs which require additional contributions to be made, often by the Government. The unexpected costs are in part a result of the fact that cost controls have not been established by most SOE pension funds. There seems to be a widespread lack of awareness of both the administrative costs of operating pension programs and the costs of benefits provided. In many cases, key decisions in SOEs -- such as salary increases, changes or increases in pension benefits, or the addition of new participants and beneficiaries -- are made without considering their impact on pension fund costs. Furthermore, the DGSE, as the owner's representative, is in most cases required to provide funds to cover any shortfall caused by such changes, but is not systematically kept informed of key decisions leading to these changes. Further complicating the situation is the fact that accurate cost analysis and projections in defined benefit programs require detailed actuarial analysis, which is difficult to obtain and rarely used by SOE pension funds.⁶

Determining benefit costs is particularly problematic because procedures for administering benefits appear to be vague. It may be difficult, particularly if a pensioner or his family lives in a remote area, to determine a number of key factors, including the age of a participant, the extent of a disability, the death of a participant, the identity of legitimate widows/widowers and children, and the age of children who are receiving death benefits.

⁶ *There is a critical lack of trained actuaries in Indonesia. Actuarial studies are not offered by any Indonesian institution -- training in this area must take place overseas. According to one source, there are only 30 Indonesian actuaries, 5 of whom are no longer practicing.*

These factors are critical in determining who should receive a pension and how much they should receive, and weak controls can substantially affect a pension fund's benefit costs.

Actuarial assumptions are not uniform in all SOE pension funds, nor do they appear to be consistently applied year after year. While most companies prepare some kind of annual actuarial report on their pension funds, the methods used for actuarial calculations are not comprehensive. In particular, demographic statistics on mortality, morbidity and disability are needed. The Indonesian Association of Insurance Companies is in the process of preparing domestic mortality tables which could provide standards in this area.

Auditing practices vary, but audits conducted by independent auditors do not appear to be widespread. More typically, an annual audit is conducted by internal auditors only.

4. SOE Pension Fund Assets and Investment Management

While total assets of SOE pension funds as of the end of 1991 are estimated at more than three trillion Rupiah (approximately US\$1.5 billion), valuation of these assets is difficult. There are no common valuation procedures, and it is likely that the widespread use of historic purchase price to establish asset value creates broad distortions. SOE pension funds do not currently use custodians to safeguard their assets.

No general Government guidelines exist regarding pension fund investment management. There are few restrictions on the types of investment allowed and few limits on specific investments. Most SOE pension funds do not have clearly defined investment objectives, and a variety of investment practices exists. Many of these practices may not be in the best interest of the participants. In-house investment expertise is not promoted by SOEs, and pension fund investment performance is not systematically tracked. In general, investment practices by pension funds are not well structured and are loosely controlled.

The majority (at least 60%, according to most sources) of SOE pension fund assets are invested in time deposits, and of this amount at least half is placed in state-owned banks. The MOF has set a limit of 10% of total assets on the amount a pension fund can place in private banks. Pension fund investments in the capital market are concentrated on bonds (in some cases up to 5% of total assets of the pension fund), with only minimal levels of investment in equity shares.

Some SOE pension funds make venture capital investments, with funds being invested directly in companies related to the founder. A typical example would be an SOE that wishes to establish or make a direct investment in a company, but is legally not permitted to do so. In this case, the SOE would direct its pension fund to invest in the company, effectively serving as a proxy for the founder. This type of venture capital investment may be in some cases as high as 20% of a pension fund's assets.

Other investment vehicles for SOE pension funds include real estate and low-interest loans to employees. Investments in real estate and land, including commercial real estate and housing, often amount to 5% or more of a pension fund's assets. Many SOEs also use pension fund assets to provide loans (usually at below-market fixed rates) to employees. Some SOEs have indicated that this type of investment can total up to 10% of pension fund assets. A few SOE pension funds invest in foreign assets, but this practice does not seem to be widespread.

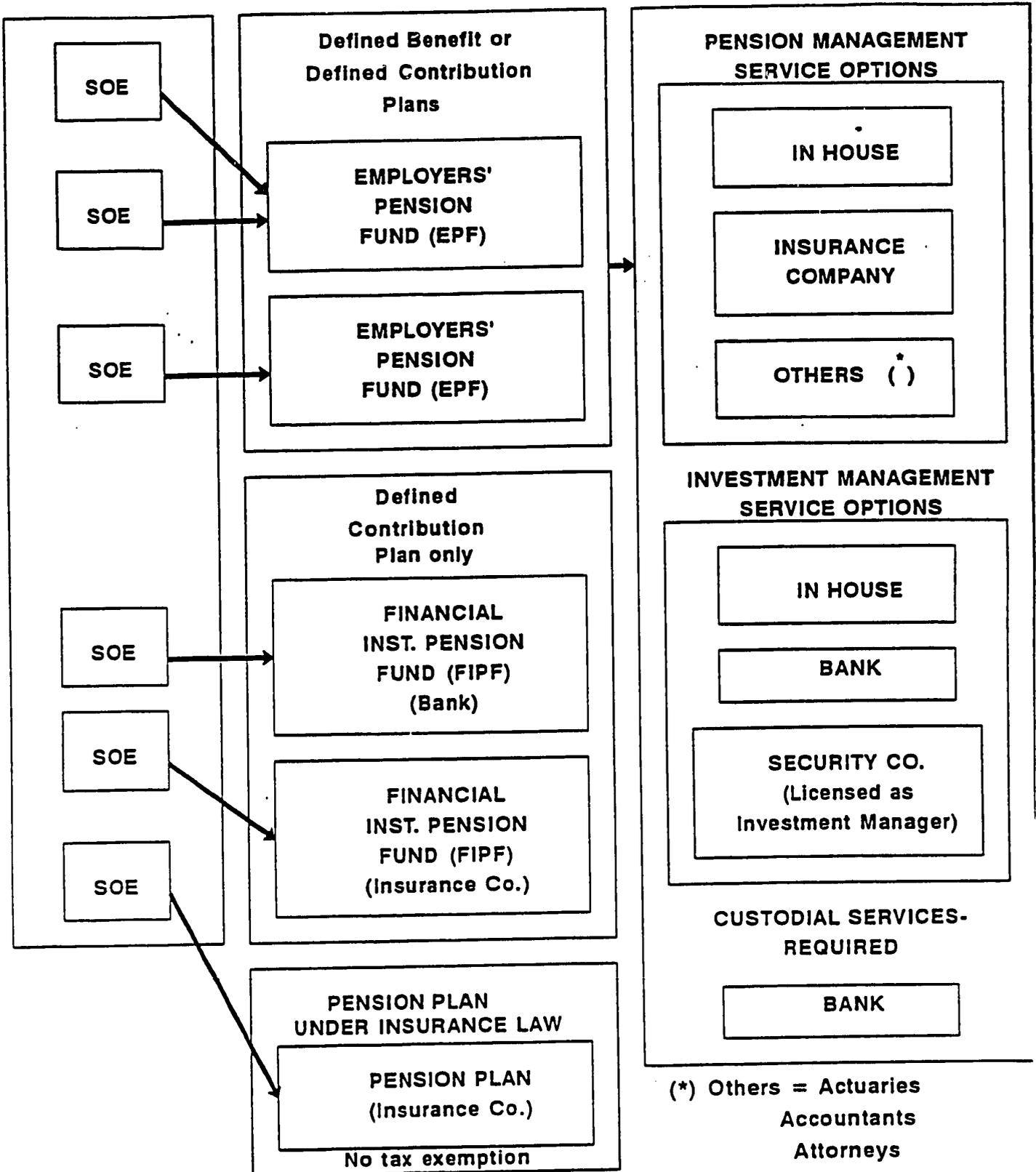
Discussions with industry observers indicate that transaction costs may be very high for SOE pension funds. Standard practices have not yet been developed to negotiate brokerage fees in a way that takes advantage of the large volume of funds invested by SOE pension programs.

MAIN OPTIONS FOR SOE PENSION FUNDS

FOUNDERS & CO-FOUNDERS

PENSION FUNDS UNDER PENSION FUNDS LAW

SERVICE OPTIONS FOR EPFs



(*) Others = Actuaries
Accountants
Attorneys

III RECOMMENDATIONS

In addition to ensuring compliance with the new Pension Funds Law and its implementing regulations, the Directorate General of State Enterprises in its role as representative of the owner of SOEs will need to consider further regulating and supervising SOE pension funds by issuing additional guidelines and implementing instructions on the formation and operation of the funds and on requirements for reporting to the Directorate General.

The recommendations made in this chapter are based on the findings and conclusions discussed in Chapter II. The majority of these recommendations are directed at the Directorate General of State Enterprises, and are intended to provide input into the process of developing a system to regulate and supervise the pension funds of state-owned enterprises.

In the course of carrying out this assessment, however, some conclusions were reached that concern the general pension fund environment in Indonesia. Given that SOE pension funds must operate within this general environment, a few general recommendations concerning broader issues are presented for consideration by the MOF. These recommendations are aimed at the MOF broadly and at the Department of Pension Funds specifically.

A. Ministry of Finance Recommendations

While the scope of work for this project focused specifically on SOE pension funds, analysis has suggested these recommendations concerning the general pension fund environment in Indonesia, which focus on issues that could strengthen the management of pension funds and their role in the Indonesian economy. We respectfully submit these recommendations for consideration by the Government.

- #1. Any constraints on life insurance companies providing a full range of services to pension funds, including pension and investment management services, should be reconsidered. The Insurance Law and the Capital Market Decrees appear to indicate that life insurance companies are precluded from providing such services. There are several reasons why life insurance companies should be allowed to offer a full range of services, not the least of which is the fact that they are among the few entities capable of doing so.

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- #2. The creation and development of specialized pension management and investment management entities should be supported, particularly through joint ventures with internationally experienced companies. Both pension management and investment management are increasingly sophisticated and technology-intensive, and require qualified personnel. Companies which already provide these services for the local market, especially state-owned companies, should be required to improve their standards and to compete for the clients on the basis of cost and performance. No captive market should be allowed.
- #3. The GOI should consider encouraging the creation of a financial instrument rating capacity in Indonesia. This is a long-term prospect, but could play an important role in ensuring that adequate information is available on different investment instruments. Control of the risks assumed by pension funds, through regulations allowing them to acquire only rated instruments of certain classes, would be facilitated by the existence of a financial instrument rating capacity to be implemented over time.

B. Directorate General of State Enterprise Recommendations

The Directorate General of State Enterprises has expressed a desire to develop an effective system for regulating and supervising SOE pension funds. This section contains a series of recommended guidelines that could serve as the basis for such a regulatory/supervisory system. The recommendations are divided into five general categories:

- Strategic Recommendations
- Operational Recommendations
- Reporting Recommendations
- Recommendations for Small SOEs and Financially Weak SOEs
- Human Resource Development and Training Recommendations

Chapter IV presents an action program designed to implement these recommendations.

1. Strategic Recommendations

The recommendations in this section focus on issues related to the general monitoring and oversight framework for SOE pension funds to be established by the DGSE.

- #4. Establishment of pension funds by SOEs should be voluntary. Virtually all SOEs today have some type of a pension program, but the DGSE should not require an SOE which currently does not have one to establish a pension fund. It should be the decision of each company whether or not to set up a benefit program for some or all of its employees.

When an SOE does establish a pension fund, however, the fund should be planned very carefully and established as a permanent program. Although SOEs should be free to alter or terminate the plan at a future time, if necessary, the DGSE should emphasize the need to create stable and permanent pension funds.

- #5. All SOE pension funds should be required to conform to the new Pension Funds Law. As described in Chapter II, Section A.1 of this report, it is possible for Indonesian companies to establish pension programs that do not conform to the Pension Funds Law, but instead follow the Insurance Law. The DGSE should not allow SOEs to choose this option, because pension funds that follow the insurance law:

- a) are not eligible for tax exemptions, and as the representative of the SOEs' owner, the DGSE has an important interest in the savings offered by such exemptions; and
- b) are not controlled by the MOF Department of Pension funds, making it more difficult for them to be regulated and supervised by the DGSE.

While all SOE pension funds should be required to comply with the new Pension Funds Law, each SOE should have a choice, when possible, on how to achieve this compliance. SOEs should be responsible for informing themselves of the requirements of the new law and its implementing regulations, and for ensuring that full compliance is achieved by the deadline -- April 20, 1993. If an SOE foresees or encounters any problems in the process of achieving this compliance, it should seek guidance from the Directorate General.

SOE pension funds should be required by the DGSE to adapt to the new Pension Funds Law in as short a period as possible, taking into consideration the financial strength of each SOE and SOE pension fund.

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- #6. The DGSE should require SOE budgets and balance sheets to reflect the requirements of their pension funds. Both SOE annual budgets and SOE long-term plans should include pension fund requirements, based on actuarial calculations. Unfunded liabilities should be appropriately reflected in SOE balance sheets. A report should be prepared that matches unfunded liabilities as stated in the fund's financial statement with those established in the SOE financial statement, because the accounting principles used by the pension fund may be different from those used by the SOE.

2. Operational Recommendations

The recommendations in this section deal with guidelines that should be established by the DGSE regarding the operations of SOE pension funds. These recommendations are divided into the following categories: a) goals, type and structure of fund, b) pension management, c) contributions, benefits and participants' rights, d) transparency and accountability, and e) investment management.

a) *Goals, Type and Structure of Fund*

- #7. SOE pension programs should be integrated with the company's overall human resource development strategy. The DGSE should encourage SOEs to design their pension programs as part of the broader subject of employee benefits.
- #8. The DGSE should not dictate to SOEs the type--defined benefit (DB) or defined contribution (DC)--of fund they can operate. Most SOEs currently have defined benefit plans, rather than defined contribution plans; there is no reason for the DGSE to change this. Both types of plans should be permitted, and SOEs allowed to choose which type best meets their needs.
- #9. The DGSE should, however, advise and assist SOEs in choosing between DB and DC plans, if requested. Both DB and DC plans have distinct advantages. The DGSE should be ready to assist SOEs in understanding the differences between these two types of pension funds and the advantages of each type.

Defined benefit plans confer a number of important advantages:

- They allow employers to fulfill income replacement objectives with a pension program. DC plans, on the other hand, are likely to result in benefit levels

that either fail to meet or exceed such objectives, depending on various external factors such as inflation, interest rates, age of the beneficiary, etc.

- They allow employers to relate benefit levels to an employee's last salary, ensuring that a retiree receives benefits equivalent to at least a certain percentage of his/her final salary. This protection cannot be obtained with DC plans, where benefits depend on investment results and must be protected against inflation during the pre-retirement period.
- They make it easier to consider a variety of variables in determining benefit levels, such as past service and an employees's age and salary. Benefits under DC plans are typically based only on salary, although past service can be considered under certain arrangements.
- They allow an employer to take social security benefits into consideration when calculating benefits levels, so that a target benefit level can be achieved by combining social security and pension benefits. It is difficult to achieve this type of integration with a DC plan, because benefit levels vary and are difficult to predict.
- They allow an employer to assume the investment risk and reward. Under DC plans, the investment risk and reward are borne by the employee.

Defined contribution plans, however, also have a number of operational and technical advantages. Defined contribution plans allow employers to share the risks of their pension programs with their employees, thus reducing the potential need for unpredicted resources. For this reason, *the DGSE may want to encourage SOEs operating in a competitive environment, who require clear projections of current and future financial needs, to consider DC pension plans.* DC plans also may be more appropriate for newly-formed SOEs, small SOEs and financially weak SOEs, because they do not carry the same potential financial liabilities for the employer as DB plans.

- #10. *Given the present level of development of the pension industry in Indonesia, the DGSE should not encourage SOEs to implement profit-sharing pension plans at this time.* An exception might be financially weak companies, which may not have other alternatives. Profit-sharing plans do not impose a fixed commitment upon employers, and allow most of the risk to be shifted to employees, but they offer uncertain levels of benefits. Employers that value defined levels of benefits for their employees and are willing to assume more risk should not choose this approach.

As the pension industry in Indonesia becomes more sophisticated, profit-sharing pension funds are likely to become an interesting alternative or complement to other types of pension programs. Profit-sharing plans might interest employers who are searching for a plan that links productivity to pension benefits and offers employees an incentive to perform more efficiently.

- #11. The DGSE should require all SOE pension funds to have a well-articulated statement of purpose. An organization's statement of purpose typically defines its intended beneficiaries, the "products" or "services" it provides them, and how its performance is to be measured. A statement of purpose is critically important in that it guides the definition of an organization's objectives, functions, structure and personnel requirements, and sets the tone for its day-to-day operations. It is particularly important that SOE pension funds be required to define or otherwise revise any existing statements of purpose given the recent changes in the Pension Funds Law, and given the Government's broader imperative to improve the efficiency of SOEs in order to reduce their burden on the national budget.
- #12. The DGSE should require SOE pension funds to become fully funded in as short a time as possible. Fully funded systems encourage financial discipline, actuarial awareness and a long-term perspective. They also seem to be less vulnerable to group pressures for increased benefits, because any immediate increase in benefits must be offset by an immediate increase in contributions. A policy of fully funding pension programs sends a message to pension fund participants that there is a real commitment to paying all promised benefits.

Most SOE pension funds, which are DB plans, are not fully funded at present. Any savings generated by an unfunded DB plan is invested in the founding company. Full funding, provided the investment portfolio is properly diversified, allows a reduction in the risk of default on the offered pension benefits.

The Pension Funds Law includes provisions on funding and solvency, which will be elaborated upon in the implementing regulations. Current pension costs (benefits accrued in the current year by employees plus operational expenses) must be funded. The implementing regulations will specify the period within which pension funds must amortize prior service liabilities. In addition, Article 61(6) of the law states that the Minister can allow unpaid liabilities for years of service prior to the date the law was promulgated to be paid in installments over a period of time longer than that stipulated in the provisions on funding and solvency.

The DGSE may want to encourage SOE pension funds to comply within a shorter

period. A shorter period of time for SOE pension funds to fund past service liabilities will require a greater financial effort by SOEs but will increase transparency and confidence in the pension system. The DGSE should establish minimum requirements for amortization payments. To ensure that unfunded liabilities do not increase, minimum amortization payments should be higher than interest payments on unfunded liabilities, with promised gradual increases.

b) Pension Management

- #13. *The independence of pension funds from SOEs should be clearly established.* Pension funds should be managed as entities separate from their founding companies and should not be viewed simply as extensions of the founders. High-quality, independent pension management is critical; it will improve performance, enhance operational autonomy, help eliminate conflicts of interest and ensure that pension funds' resources are devoted solely to supporting their benefit programs. The Boards of Supervisors of SOE pension funds should be given full autonomy to improve pension management and to work creatively. Autonomy of SOE pension funds can only be achieved if experienced professional managers are given independent authority.

Independence does not mean that an SOE no longer has a role in its pension fund. The SOE is the founder of the fund and maintains a high level of responsibility, especially in the case of DB plans and plans that are not fully funded. SOEs should provide operational guidance, control and discipline only. Once general directives are established, management should be exercised independently and decisions based on the interests of the participants rather than those of the SOE.

- #14. *The DGSE should require SOE pension funds to use external, professional management services, making exceptions on a case-by-case basis only.* If a company feels that it has the experience and capability needed to establish effective and independent in-house management for its pension fund, it should be required to seek approval from the DGSE. The DGSE should approve these requests on a case-by-case basis, after carefully reviewing the proposal of the SOE. Unless an SOE has specific approval from the DGSE to manage its own pension fund, it should be required to use an outside manager.

The trend in recent decades, in both developed and developing countries, has been toward using professional expertise and technology in pension management. This expertise and technology is needed to handle the complex concerns of pension fund managers, including long-term strategic planning for pension assets, service to

participants and adaptation to evolving pension legislation and reporting requirements. As the size of pension funds increases, it becomes increasingly important that the management of this large amount of resources be handled by specialists with professional expertise and knowledge of the appropriate technology, rather than being delegated to non-specialized employees of the founder who are given only broad guidelines. Use of professional, experienced managers is likely to greatly enhance the performance and strengthen the financial viability of SOE pension funds.

The DGSE may want to make specific recommendations on the use of selected pension and investment managers, based on a careful analysis of potential sources for this type of management.

#15. Participants' representatives to an Employer's Pension Fund's Board of Supervisors should be chosen directly by the participants, including pensioners. The Pension Funds Law requires that 50% of the members of the Board be representatives of the participants. Guidelines issued by the DGSE should encourage active participation by both employees and pensioners in the selection of those representatives and should make it very clear that the founder does not have the right to reject the representatives chosen by participants.

#16. Accounting standards to be used by SOE pension funds should be established, and the format and frequency of reports to be submitted by them stipulated. It is important that the DGSE receive financial statements in a uniform format, using the same basic accounting principles. The accounting standards should be set at a reasonable level, one that will not be too expensive and difficult for SOE pension funds to prepare, but that will be complete enough to permit adequate control by the DGSE.

It is likely that accounting standards will be set for all pension funds by the MOF Department of Pension Funds through the implementing regulations. Depending on the level of detail and completeness of the MOF standards, it may be necessary for the DGSE to establish additional, more detailed accounting standards.

#17. The DGSE should require SOE pension funds to undergo a yearly audit of the fund's financial statements by independent external auditors. The implementing regulations to support the Pension Funds Law will be instrumental in determining how much the DGSE can and should require in this respect.

#18. The DGSE should establish uniform actuarial assumptions for the purpose of comparing and ranking SOE pension funds. For the purpose of estimating long-term costs and preparing financial statements, however, each SOE pension fund should be

allowed to establish actuarial assumptions appropriate for its own situation and needs. Actuarial assumptions are used by pension funds to estimate long-term costs, especially benefit costs. Uniform actuarial assumptions cannot be used to establish actual costs for a wide range of pension funds, but are useful in comparing and ranking different benefit programs. It should be made clear that the uniform assumptions made by the DGSE for purposes of comparison need not be used by SOE pension funds, which may want to use different assumptions that are more appropriate for their needs.

There are several methods that can be used by pension funds to determine actuarial costs for current services, which can be broadly classified into accrued benefit or projected benefit methods. Classification of a cost method depends on the way benefits are accrued in relation to years of service or as a single projected total. While the method chosen by a pension fund will affect annual contributions, both types of methods will result in an identical present value. In addition to selecting a cost method, a number of basic actuarial assumptions must be made to value the liabilities of the pension plan, such as the rate of future salary increases of employees, employee turnover, rate of return on assets, retirements, and operational expenses.

- #19. The DGSE should require all SOE pension funds to use professional actuaries in the preparation of financial statements. Implicit in the recommendation is a need to support the actuarial profession in Indonesia, which is currently very weak.

c) *Contributions, Benefits and Participants' Rights*

- #20. The DGSE should not require SOEs to include all employees in their pension programs, although they should be encouraged to include as many employees as possible. SOE pension plans should make every effort to include, at a minimum, all permanent employees, both men and women. Employees with low levels of compensation should not be discriminated against in making contributions or in receiving benefits. If different levels of benefits are to be offered to different groups of employees, separate pension plans should be used.

- #21. Employees should be required to make contributions to SOE pension funds. While the new law does not require employee contributions to pension funds, the DGSE should require SOE employees to have a certain level of responsibility in making pension fund contributions, especially for death and disability benefits, but also for retirement benefits. Sharing responsibility for the costs of a pension program increases awareness among employees. This is important at SOEs in Indonesia, where employee attention and understanding of pension plans currently seems to be low.

Most SOEs today do require employee contributions, at levels ranging from 25% to 50% of total contributions. (The same levels are often seen in other countries, although 100% employee contributions apply in some cases.) There is no good reason for this approach to be changed. Employee and employer contribution levels for SOE pension funds should be set individually by the SOEs, not by the DGSE. The DGSE should, however, maintain the right to set restrictions on these levels.

In the case of defined contribution plans: Employer contributions higher than 15% should require DGSE approval, as should increasing contribution rates, as such contributions would impose large burdens on an SOE.

- #22. Contributions to pension plans and benefits received should be calculated from base salary plus allowances. Most SOEs today use base salary only when calculating contributions to pension funds and benefits to be received. Because base salaries are often only a small part of an employee's gross compensation, this can lead to artificially low levels of contributions and benefits.

The DGSE should require SOE pension funds to carefully evaluate the definition of salary that is used to calculate contributions and benefits, and to use a definition that includes base salary plus all or most allowances. Each SOE should conduct its own analysis and make its own decisions, within certain guidelines set by the DGSE, because of the different salary components used by each SOE. If contributions and benefits are closely based on real gross salary, there will be fewer incentives to increase the percentage rate of accrued benefits.

- #23. SOEs should be subject to stiff penalties for making late employer contributions to pension funds. Article 17 (3) of the Pension Funds Law stipulates that if an employer does not pay its pension fund contributions on a monthly basis, as stipulated in Article 16, it must pay "proper interest" on the late funds. ("Proper interest" is defined as the deposit rate used by government-owned commercial banks.) The intent of this article is to ensure that pension fund participants receive a return even if the employer does not make contributions on time; a practical side effect of the article, however, is

to make pension fund contributions a potential source of cheap loans for the employer.

Article 55 of the law specifies that the MOF can also charge an additional penalty in an effort to force employers to pay their contributions on time. Further details on this subject will probably be included in the implementing regulations. If the regulations do not specify stiff penalties for late payment of employer contributions, the DGSE should do so.

- #24. The DGSE should not require uniform benefits to be offered by all SOEs. Standard principles and guidelines regarding benefit levels, such as those proposed in this report, should be established, but a uniform benefit plan for all SOEs would not be appropriate given the varying industries, types of workers, and needs of different SOEs. Each SOE today determines its own benefit levels; this practice should not be changed.
- #25. SOE pension programs should seek to strike a balance between very low and excessive levels of benefits. While benefit levels that are too low can hinder the retention of desirable employees, excessive benefits lead to excessive costs and will not help to attract these workers. The DGSE should provide broad guidelines and advice or assistance to SOEs in determining appropriate benefit levels.

With regard to minimum benefit levels, SOEs should simply be required to comply with the law; as long as that compliance is achieved, the DGSE need not involve itself. It would be useful, however, for the DGSE to establish maximum benefit levels as a means of controlling the total financial requirements of SOE pension funds.

Today, most SOE pension programs calculate retirement benefits as a certain percentage (typically 1.5% to 2.5%) of the final salary multiplied by the number of years of service at the SOE (up to a specific limit, usually about 60% to 75% of final salary). This type of formula could be broadly used, with details being determined individually by each SOE. The DGSE should set an upper limit on the percentage that can be used by SOEs in determining their formulas (2.5% of final salary times years of service, for example); SOEs that wish to use higher figures would have to seek special approval from the DGSE. The number of years of service used in these calculations should also have an upper limit, and schemes which allow retirement pensions higher than 75% of final gross salary should be required to receive special DGSE approval.

The law requires death benefits for participants' widows or widowers to be at least 60% of the pension the participant would have received. Each SOE should have the right to define its own level of death benefits, although figures in excess of 70% should be required to receive special approval from the DGSE.

Disability pensions should be equal to the current value of deferred pensions; higher values should require special approval by the DGSE.

- #26. The DGSE should encourage SOE pension funds to provide protection against inflation for benefits paid to participants. This would protect beneficiaries from having the value of their pensions eroded by inflation and would provide incentives for the development of inflation-indexed instruments in the capital market.
- #27. The DGSE should require SOEs to link pension fund benefits to the benefits provided by the national social security system. Formulas could be devised that would allow pension fund benefits to be increased or decreased, depending on the level of social security benefits to be provided. This will be particularly important if a very high level of social security benefits is established (see comments in Chapter II, Section A.2) or if social security benefits are substantially increased at a later date.
- #28. SOE pension programs should exercise care in establishing provisions for recognizing prior years of service. There is no requirement that years of service prior to inception of the pension program be counted when calculating benefits, although doing so seems to be a general practice among SOEs. When an SOE offers a new pension plan, recognition of past service should only be offered to employees if the SOE concludes, after careful actuarial calculations, that adequate funds are available to finance the additional liabilities. SOEs should be required to seek DGSE approval for such decisions.
- SOEs should not offer past service credit for years of service in different organizations, including other SOES, the Government and other companies.
- #29. The DGSE should encourage and assist SOE pension funds in applying the principle of portability, as it is described in Article 26 (2) of the Pension Funds Law. The law establishes that participants who stop working for an employer more than 10 years before reaching the normal retirement age have the right to either receive a deferred pension from that employer's pension fund or to transfer their pension to another EPF or an FIPF. It should be up to the participants to decide whether to retain their rights to a deferred pension with the former employer's pension fund or to transfer rights to a new pension fund.

In the case of defined contribution plans it is easy to determine the value to be transferred, but in the case of defined benefit plans, it is necessary to make certain assumptions⁷. Full portability and completely equitable treatment are not possible with defined benefit programs, because actuarial assumptions differ from one fund to another. It is important, however, to ensure that the value to be transferred represents as equitable an assessment of real accrued benefits as possible.

More detailed provisions on applying the principle of portability will be contained in the implementing regulations. The DGSE should allow SOE pension funds flexibility in implementing portability requirements, which, although they create an additional administrative cost for pension funds, are needed to encourage job mobility. Portability will also allow the Government greater flexibility in restructuring less profitable and less competitive SOEs in an increasingly dynamic economic context.

- #30. SOE pension funds must exercise great care in moving from the current system, which provides benefits as a lump sum, to the system prescribed in the new law, under which pension benefits will be provided in monthly installments. This type of shift can be very difficult and should be carefully planned. Among other problems, pension funds may encounter substantial operational difficulties with paying benefits to pensioners in remote areas. Coordination with and use of bank branches will probably be necessary.

Article 21 (3) establishes that defined contribution plans will offer participants the right to choose to purchase an annuity from a life insurance company. This would free pension funds from becoming involved in the process of making monthly pension payments. It is not clear if defined benefit programs may also offer this right; if so, the DGSE should encourage SOE pension funds to choose this alternative.

Article 61 (4) allows previously established pension programs (those approved by the MOF prior to promulgation of the law) which are currently making lump-sum payments to continue to do so until all obligations have been met to employees who were participants at the time the law was passed. Because this could lead to a long transition period, the DGSE should encourage SOEs, when possible, to change to a monthly payment system more quickly, offering 20% lump sum payments to existing participants. This would eliminate discrimination and make operations easier, as only one plan (rather than two) would have to be managed. In some cases, additional contributions by both employer and employees might be necessary to convert existing

⁷ The implementing regulations will include some provisions related to these assumptions.

promises of lump-sum payments to adequate monthly pensions.

Note: Pension funds that were *not* approved by the MOF prior to promulgation of the Pensions Law are not allowed to continue making lump-sum benefit payments after they register with the MOF, because article 61 (4) refers only to previously approved pension programs.

d) Transparency and Disclosure

- #31. The DGSE should impose minimum requirements for disclosure to SOE pension fund participants. SOEs should be required to ensure that their employees have an adequate level of understanding about their own pension plans. The DGSE should specify a minimum level and types of information, including descriptions of the pension plan and its performance, that must be provided to employees.

The terms of the pension plan should be communicated through an announcement letter or booklet given directly to employees. If this is not considered possible, copies of the plan should be made available for analysis at convenient locations. SOEs should hold meetings to explain to participants the main elements of the new Pension Funds Law and its implementing regulations, so that they will understand the general framework within which their pension plan is organized. Any changes to current pension programs will need to be communicated properly to employees, especially the benefit changes required by the new law. Provisions should also be made to provide information to new pension fund participants and to other interested parties on a permanent, on-going basis.

Employees, upon request, should be provided with information about their accrued and vested benefits, especially if an employee is changing jobs. SOE pension funds should be required to provide this type of information to each participant at least once a year, to increase awareness and understanding of the pension plan.

e) Investment Management

- #32. The DGSE should require SOE pension funds to use external, professional investment management services, making exceptions on a case-by-case basis only. If a company feels that it has the experience and capability needed to manage the investments of its own pension fund effectively and independently, it should be required to seek approval of the DGSE. The DGSE should approve these requests on a case-by-case

basis, after carefully reviewing the proposal of the SOE. Unless an SOE has specific approval from the DGSE for in-house investment management, it should be required to use an outside investment manager that has met the competency requirements and has been issued a license by BAPEPAM.

While in-house investment management gives an SOE control over investment decisions, it requires a great deal of expertise, training and technology, including recruitment of investment specialists, creation of a working unit, establishment of expertise, and development of computer systems and a research and information network. Professional, external investment management usually can offer better performance in terms of an increase in investment returns, a reduction in volatility of returns and lower costs. Because of the large volume of resources they manage, professional investment managers are able to: receive a great deal of information; build high-quality research teams; obtain economies of scale in operations, administration, back-up and research; and develop strong relations with major market participants, such as banks and securities companies. The skills and experience of these professional managers cannot easily be obtained by companies who wish to manage their investments in-house.

The DGSE should permit in-house investment management only if the SOE is able to demonstrate that it has well-defined investment policies and objectives, a clear investment process, professional expertise in all target markets, measures to promote creativity, and adequate employee compensation schemes associated with goals and productivity. For an SOE to continue on a sustained basis to manage its pension fund investments in-house, it should be required to show acceptable investment performance.

The DGSE may want to consider allowing SOE pension funds to make use of a combination of in-house management (for deposit portfolios) and professional, external management (for other types of assets).

- #33. *The DGSE should establish clear investment constraints for SOE pension funds, covering issues such as individual assets, conflicts of interest, allowable markets, and requirements for brokers.* Pension fund actuarial liabilities are long-term by nature and are expressed in the domestic currency. The DGSE should encourage SOE pension funds to match assets and liabilities in terms of maturity and currency to reduce risks. This is difficult, however, because it requires the availability of long-term, rupiah-denominated assets (both adjusted and not adjusted for inflation) and the capital market in Indonesia is currently short-term in its focus and real interest rates are high. While this situation is likely to change in coming years, current investment

alternatives are limited, making it difficult for pension funds to develop diversified portfolios or invest in long-term instruments.

Until the market develops further, the DGSE may wish to initially set a range of maximum limits on SOE pension fund investment (at market value) in different classes of assets. Based on experience in other countries, the following limits are suggested:

BI Certificates	no limit
Time Deposits	up to 80% of total assets
Bonds	up to 40% of total assets
Stocks	up to 20% of total assets
Real Estate	up to 20% of total assets
International Investments	up to 30% of total assets

These suggested limits should be subject to further analysis and refinement.

No public commitment should be made to increase SOE pension funds' investments in bonds and stocks in the short term. While pension funds in developed countries typically invest between 40% and 60% of their portfolio in stocks, the capital market in Indonesia is still developing, making it difficult for Indonesian pension funds to increase their bond and stock holdings in the near term.

Depending on the investment provisions contained in the implementing regulations, the DGSE should limit each SOE pension fund's total investment in instruments of one issuer, including related companies but excluding Government instruments. A suggested limit is 10% of the fund's total assets.

Limits should also be placed on the total percentage of shares of one company that can be owned by an SOE pension fund. A suggested limit is 10% of the shares of a company. An SOE pension fund should also not be allowed to own more than a certain percentage (10% is suggested) of each issue of bonds or other instruments issued by a company. All SOE pension funds together should not be permitted to own more than 40% of the shares of a company.

Investments in real estate by SOE pension funds should require appraisals from an independent party. Property investments should be made only at market prices and primarily in property suitable for more than one use to facilitate re-leasing, if required. Investments in commercial property should be preferred to those in housing. Direct housing investments should not be allowed, because there are too

many incentives for imposing below-market prices and conditions when leasing houses to pension fund participants or other related parties. Because property is usually an illiquid investment, concentration of a pension fund's property portfolio in a few assets should be avoided. The DGSE should set a limit of 2% of an SOE pension fund's portfolio for each individual real estate investment.

Investments in venture capital and in unlisted stocks should be avoided at this stage of development of pension funds in Indonesia. These types of investments are currently illiquid in Indonesia, making their market values difficult to establish. Venture capital investments by pension funds are often, as is generally the case with SOEs in Indonesia today, related more closely to the interests of the founding company than those of the pension fund's participants.

To avoid conflicts of interest, the DGSE should not allow SOE pension funds to carry out certain types of transactions that involved interested parties. Such transactions would include: sale, acquisition or lease of property; loans or extensions of credit; investments in debt securities; and transfer of fund assets.

Note: All suggested limits are subject to further review.

- #34. The DGSE should require SOE pension funds to establish written investment objectives and policies. An investment policy is a statement of the founding company's preferences on a variety of issues, such as purpose, risk level, asset mix, and performance targets of a pension fund. An investment policy provides the guidelines and procedures that shape the management of the fund's assets; it encourages and facilitates long-term planning.

The process of developing investment objectives and preparing an investment policy requires the founder and management of the pension fund to focus on investment management, thus increasing their awareness of a topic that is often not given enough attention because of its technical nature. If a pension fund is to manage its investments in-house, this process can serve as a training tool. If external management is to be used, the process facilitates communication of the founder's wishes and allows it to act as a risk controller.

It should be noted, however, that the lack of a wide variety of investment alternatives in Indonesia today may limit the scope of investment objectives and policies.

An investment policy should be prepared as a formal, written document, and should include the elements described below. The rationale behind the company's decisions and choices on each topic should be explained.

- **Purpose and Objectives:** A pension fund's statement of purpose (see Recommendation #11) will shape its investment policies and objectives. The investment objectives of the fund need to be declared, and indicators defined that will signal success. Examples of such indicators could include a return equal to the average return on time deposits for fixed income investments and a stock market index for stock asset classes.
- **Risk level:** The risk tolerance of a pension fund should be clearly specified. Different risk results can be produced by different asset mixes and investment management structures. For example, if a fund wishes to minimize variations in expenses, investment in equities should be reduced. If variation of total assets is important, a more conservative approach should be chosen. Reinvestment risk must be considered, especially in a capital market which does not currently offer a full range of long-term instruments. The impact of a pension fund's risk on the risk of the founder must also be taken into account.
- **Asset mix:** The allowable and desired mix of assets should be clearly spelled out, as the classes of assets chosen will broadly determine the performance of the fund.
- **Investment management:** Whether a pension fund is to manage its investments in-house, use an external investment manager or combine the two approaches, investment management guidelines need to be established. While the investment policy will define basic principles, specific investment decisions will be made by the investment manager of the fund, who should receive clear instructions. Investment management guidelines should include a clear delegation of authority and responsibilities to the fund manager, the investment manager and the Board of Supervisors. If an external investment manager is to be used, who is responsible for selecting and hiring that manager? Who will determine which brokers will be used? What is the maximum percentage of a fund's assets that can be traded through each selected broker? What other intermediaries can be used by the fund? These types of questions should be addressed at this point.

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- **Performance evaluation:** A pension fund should decide how it will evaluate and analyze performance. This involves evaluating performance as it relates to each key decision area: objectives, risk level, asset mix, investment management, etc. Performance evaluation will provide insights needed to adapt the investment policy, if necessary.

#35. The DGSE should require SOE pension funds to follow rigorous procedures when selecting external investment managers, favoring investment managers with domestic and international experience. SOEs should prepare questionnaires and conduct interviews as part of this process. In addition to knowledge of a potential investment manager's integrity and reputation, which are crucial, SOEs should have the following information about candidates they are considering hiring:

- Basic information about the firm, such as years of existence, financial statements, ownership, future plans, earnings base, related interests, etc.
- Total assets being managed, descriptions of international experience, if any, and a list of clients.
- Information on key personnel and principals, their personal expertise and their commitment to the firm.
- The firm's investment approach, style of management, decision-making routines and control disciplines.
- Performance record.
- Fees.
- The kinds of reports that can be provided to the pension fund management. It is important that investment managers be able to adapt their reporting and accounting systems to meet any special requirements of their clients.

Agreements should be drawn up with selected investment managers that specify in detail the duties and responsibilities of the investment manager, the quality of service that must be provided, the requirements for reporting to the founder, etc. These agreements can be used to ensure that investment managers follow the investment policies of the SOE pension funds.

3. Reporting Recommendations

This section contains recommendations dealing with the requirements that should be established for reporting by SOEs to the DGSE and by the DGSE to the Minister.

a) *Reporting to the DGSE by SOE Pension Funds*

The reporting requirements determined by the DGSE are of critical importance, as the types and amounts of information received will determine the Directorate General's ability to supervise SOE pension funds and ensure that they are following its operational guidelines and instructions. To control costs (i.e., eliminate or reduce end of the year cost overruns that require infusions of DGSE funds), the DGSE must have the information it needs to monitor and control changes at SOE pension funds.

Detailed information will also better enable the DGSE to provide technical assistance to SOE pension funds, as requested.

#36. The DGSE should require each SOE pension fund to provide, on a regular and ongoing basis, aggregate and detailed information on a wide range of topics. The information and reporting requirements of the DGSE will depend to a large extent on the reporting requirements specified in the implementing regulations. Although the implementing regulations have not yet been issued and it is not clear what types and levels of reporting will be required generally by the MOF, it is likely that the MOF will require pension funds to submit statements of assets and liabilities, changes in net assets, revenues and expenses, and explanations of the actuarial method and assumptions used to calculate liabilities. Depending on the level of detail specified by the MOF, the DGSE may want to require additional information or more frequent receipt of reports on certain topics such as assets, investments and transactions, contributions, expenses, benefits, and actuarial evaluations.

The following types of information should be received by the DGSE, either via the DPF or directly from SOE pension funds:

- General information: Any general decisions or changes that will affect the assets or liabilities of an SOE pension fund, such as salary increases or changes in the number of employees participating in the pension fund.

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- **General management:** Any significant management changes or problems, including changes to the Board of Supervisors. Management reports should include information on the administrative costs of operating the fund, covering detailed information on any person or entity receiving payments from the fund for services rendered, amounts paid, relationship with the founder or other interested party.
 - **Actuarial methodologies:** Information on actuarial methods and valuations applied by SOE pension funds.
 - **Financial statements:** These statements will assist the DGSE in evaluating the viability of the fund and help eliminate unexpected resource outflows at the end of the fiscal year. The DGSE should receive detailed information from each SOE pension fund showing the valuation of financial assets by type of asset (total value of time deposits, bonds, stocks, etc.). If the procedures for asset valuation established in the implementing regulations allow pension funds to carry assets at book value, the DGSE should require SOE pension funds to also include valuation at market value in their reports. The definition of "market price" will depend on the class of asset; in cases where markets are not deep, professionally prepared appraisals should be used.
 - **Audit reports:** To the extent possible, prepared annually by independent, external auditors (Recommendation #17).
 - **Funding performance:** Regular reports that would enable the DGSE to track each pension fund's progress in funding its past service liabilities. The unfunded status of an SOE's pension fund should be regularly reconciled with the SOE's financial statement; the DGSE should be provided with these reconciliations.
 - **Contributions and benefits:** Including information on changes or increases in benefits and on changes to contribution structure or levels.
 - **Investment performance and transactions:** Including information on portfolio composition, investment returns and transactions. The DGSE should develop a system for monitoring the investment performance of SOE pension funds (who should be tracking their own investment performance, anyway).

Initially, the DGSE can be expected to have limited capacity to absorb detailed data. The monthly flow of data upon which the DGSE would base its tracking

of SOE pension fund performance would need to be tailored to the DGSE's absorptive capacity. Ultimately, as feasible, the DGSE should receive on a regular basis (e.g. monthly) the details of every transaction of every SOE pension fund. It is suggested that the following data be required on all acquisitions and sales:

- Investment manager
- Date of transaction
- Market where transaction was executed
- Condition of transaction (cash, 24 hours, etc.)
- Type of asset (time deposit, bond, stock, etc.)
- Issuer
- Amount of investment
- Serial identification of instrument
- Price and number of stocks
- Duration and nominal interest rate (for fixed rate instruments)
- All transaction costs
- Broker who handles transaction
- Identification of the instrument (number, etc.)

Such reporting would allow the DGSE to conduct analyses that will reveal whether transaction costs are under control and investments are being selected carefully by individual SOE pension funds. In addition, with this type of detailed information, the DGSE would be able to create its own data base, containing portfolio information on all SOE pension funds. This data base would allow the DGSE, using uniform valuation procedures, to compare the value of financial assets with the value calculated by pension funds, and to compare--either for all operations or on a selective basis--the prices and conditions of individual operations with market prices and transaction costs. Any differences should be explained to the DGSE by the responsible officials of SOE pension funds.

- #37. The Directorate General should prepare standardized formats for the various reports (actuarial, audit, investment, etc.) to be submitted by SOE pension funds. These standardized formats would provide the DGSE with data to be fed into pension fund-specific information modules that would form an integral part of a broader, DGSE-wide management information system.

b) *Reporting by the DGSE to the Minister*

- #38. Methods to value and rank different pension programs should be established which would allow the DGSE to compare the performance of and costs incurred by different pension funds and investment managers. This type of ranking and valuation would encourage efficiency and cost effectiveness at SOE pension funds and would be a useful supervisory tool for the DGSE.
- #39. Periodic reports on SOE pension fund performance should be prepared by the DGSE and submitted to the Minister of Finance, in accordance with its overall reporting responsibilities. These reports should contain aggregate and summary information on all SOE pension funds and should provide comparative figures on benefits, costs, and investment performance. These reports should disclose the ranking and comparisons resulting from the process recommended above, as this would be an important part of the process of creating performance and cost competition among pension funds and investment managers.

4. Recommendations for Small and Financially Weak SOEs

Small SOEs and financially weak SOEs have special pension fund needs. The recommendations contained in this section deal with the needs and requirements of these types of funds.

- #40. The DGSE should carefully assess the capacity of small SOEs and financially weak SOEs to operate individual pension funds. Individual pension funds, especially defined benefit plans, impose a degree of financial risk which may not be appropriate for these companies. In addition, single employer funds would not permit small and financially weak SOE pension funds to profit from economies of scale, which are high in the pension industry. The DGSE could make decisions on whether or not to allow these SOEs to operate individual pension funds on a case-by-case basis.
- #41. Small SOEs and financially weak SOEs should seriously consider joining together as co-founders in multiple-employer EPFs, if the DGSE determines that this is a practical and cost-effective option. For this type of fund, either the DGSE or one of the co-founding SOEs will probably need to assume a leading role, particularly during the implementation period. Defined contribution schemes, because of the lower level of financial risk involved for the companies, may be more appropriate than defined benefit schemes for multiple-employer funds. Defined benefit plans with several co-founders are more complex to manage than single employers' pension funds and

require special actuarial and management efforts to assign costs and resources.

Note: SOEs that do not yet have pension funds should also be encouraged to join multiple-employer funds, which might also be used to provide pension benefits for non-staff workers of companies that already offer pension programs for permanent workers.

- #42. Consideration should also be given to the possibility of enrolling the employees of small SOEs and financially weak SOEs in Financial Institution Pension Funds. It must be kept in mind, however, that FIPFs can only be defined contribution programs, which are not currently popular with SOEs.

Note: The use of both multiple-employer pension funds and Financial Institution Pension Funds promotes job mobility, which should be encouraged by the DGSE.

5. Human Resource Development and Training Recommendations

The recommendations in this section cover issues related to human resource development and training for the DGSE and SOE personnel responsible for pension funds.

- #43. The DGSE should recruit and/or train a specialized staff to monitor and provide guidance to SOE pension funds. This staff should be composed of an actuary, an accountant, an investment specialist and a lawyer specialized in pension law. This staff would be responsible for obtaining and analyzing all information provided to the Directorate General by SOE pension funds and, if required, should be available to actively assist SOEs in creating or adapting their pension funds. These staff members would also draft reports on SOE pension funds for review by the Director General. The staff would need to work closely with the MOF Department of Pension Funds, and could provide advice and assistance on general pension matters as needed.
- #44. The DGSE should encourage and assist SOEs to design and implement pension-related training and human resource development programs. The DGSE should assist SOEs in developing strategies to ensure that SOE personnel have adequate skills and training to manage or oversee pension programs. The DGSE could also initiate or promote training programs for SOE personnel, either directly or in cooperation with the Indonesian Pension Funds Association.

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- #45. *The DGSE should establish guidelines for SOE policies vis-a-vis personnel responsible for pension funds.* These guidelines should be aimed at ensuring that the SOE personnel responsible for pension funds are high-quality and well-trained. Adequate compensation, which is necessary to attract qualified professionals, should also be a goal; a system of performance-linked incentives could be implemented. It is important that the DGSE focus on this area, as poor management and oversight of pension funds by SOEs could be very costly.

IV. IMPLEMENTATION PLAN

A. Introduction

This chapter contains a plan for implementing the recommendations contained in the previous chapter. This implementation plan is intended to provide the Directorate General with a strategy and program for regulating and supervising SOE pension funds. The goal of this implementation plan is to provide a structured approach that would allow the DGSE to:

- Ensure that SOE pension funds conform to the new Pension Funds Law.
- Regulate SOE pension funds by developing and implementing a structured set of operating instructions.
- Monitor and supervise SOE pension funds by developing and implementing a structured set of reporting requirements.

The implementation plan is divided into five phases and various sub-phases, as follows:

PHASE I Start-Up: Definition of Objectives and Strategy

PHASE II Issuance of Guidelines on Conformance with the New Pension Funds Law

PHASE III Development and Implementation of DGSE Instructions to SOE Pension Funds

Sub-Phase A: Design of Instructions on a Pilot Basis (for selected SOE pension funds)

Sub-Phase B: Implementation of Instructions on a Pilot Basis

Sub-Phase C: Implementation of Instructions for all Remaining SOE Pension Funds

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4. To ensure that SOE pension funds meet minimal financial and management performance criteria, to be defined by the DGSE.
 5. To promote and strengthen the financial viability of SOE pension funds, minimizing the need for the Government to make direct contributions to the funds.
 6. To improve cost awareness and the transparency of the management of SOE pension funds.

Possible objectives for supervising SOE pension funds are:

1. To ensure that SOE pension funds conform to the regulations established by the DGSE.
2. To ensure that the DGSE is kept fully informed of the operations and potential financing needs of SOE pension funds.

Output/product: Clearly stated and agreed-upon objectives for regulation and supervision of SOE pension funds by the DGSE.

Task I.2

Define strategy

Once the Directorate General has clearly identified its objectives, it should define a strategy to meet these objectives. The implementation plan contained in this report could serve as this strategy. A key issue under this task will be defining and clarifying the relationship between the DGSE and the MOF Department of Pension Funds.

Output/product: A well-defined strategy and plan for developing and implementing an SOE pension fund regulatory/supervisory system.

Task I.3

Identify means of achieving objectives and strategy

Once the DGSE has determined its objectives and laid out its regulatory and supervisory strategy, it must decide upon an appropriate means to achieve the objectives and carry out the strategy. The strategy (implementation plan) recommended in this report is based on use of DGSE in-house resources as the primary means, supplemented by outside assistance as necessary and appropriate.

The Directorate General should select and train a team of staff members to be responsible for carrying out this implementation plan. This selection and any necessary training should begin immediately, and could take place as part of a broader Human Resource Development and Training Phase (Phase V).

Output/product: Agreement upon an appropriate and feasible means of achieving the regulatory and supervisory objectives and strategy.

C. Phase II: Issuance of Guidelines on Compliance with the New Pension Funds Law

Based on Recommendation #5 in Chapter III, the Directorate General should issue clear guidelines to all SOE pension funds regarding adaptation to the new Pension Funds Law. SOEs should be responsible for informing themselves of all requirements of the new law and ensuring that full compliance is achieved by the deadline – April 20, 1993. If an SOE foresees or encounters any problems in the process of achieving this compliance, it should seek guidance from the Directorate General.

Implicit in compliance with the new law is the need to conform to the Governmental and Ministerial implementing regulations that will be prepared by the MOF Department of Pension Funds. While the implementing regulations have not yet been issued, it is expected that they will come out in the near future. It should be the responsibility of the SOEs to know when the implementing regulations are issued and to inform themselves of and ensure compliance with the provisions contained in the regulations. If an SOE foresees or encounters any problems in the process of achieving this compliance, it should seek guidance from the Directorate General.

Output/product: Official notification by the DGSE of the guidelines for SOE pension funds to comply with the new Pension Funds Law.

D. Phase III: Development and Implementation of DGSE Instructions to SOE Pension Funds

SOE pension funds, in addition to being required to conform to the new law and the DPF implementing regulations, should be required to adhere to a set of implementing instructions issued by the DGSE in its role as the representative of the owner of the SOEs. These instructions would be instrumental in enabling the DGSE to achieve its regulatory objectives.

The content of the DGSE implementing instructions should be based on the results of analysis carried out by the DGSE and on the implementing regulations issued by the DPF, and should take into account the guidelines recommended in Chapter III of this report. While the Directorate General could begin the process of preparing its instructions at any time, it could not finalize or issue them until the DPF regulations are issued.

Sub-Phase A: Design of Implementing Instructions (on a Pilot Basis)

The DGSE instructions should be prepared on a pilot basis, using a small but representative group of SOE pension funds. Commencing on a pilot basis, rather than with all SOE pension funds, will make the process of analyzing current operations and drafting instructions manageable. It will also allow the instructions to be tested and, if needed, revised before being applied to all SOEs.

Task III.A.1 Select sample of SOE pension funds to serve as pilot group

A sample of five to ten SOE pension funds should be selected to serve as a pilot group for development and testing of the DGSE instructions. This pilot group should include a variety of types of SOE pension funds, constituting a representative sample of current types of pension programs run by SOEs (in-house, insurance company, yayasan, etc.). If possible, the sample should also represent SOEs of various sizes and industries.

This task could be carried out before the DPF implementing regulations have been issued.

Output/product: A list of SOE pension funds to participate in the pilot program.

Task III.A.2 Analyze operations of the pilot group of SOE pension funds

This task involves conducting a detailed and thorough analysis of the SOE pension funds in the pilot group, as selected in Task III.A.1. This analysis should focus on all aspects of the operations of these pension funds, including: structure and current legal status, management practices, contribution levels and practices, benefit structures, internal operating procedures and decision making processes, investment objectives and practices, accounting practices, and actuarial calculations.

The objective of this task is to obtain a clear and detailed understanding of how the pension programs in the sample group operate, which is critical before the DGSE can establish the detailed instructions needed to achieve its regulatory and supervisory objectives.

As with task III.A.1, this task could be carried out before the DPF implementing regulations have been issued.

Output/product: Detailed analysis of the operations of the SOE pension funds in the pilot group.

Task III.A.3 Prepare implementing instructions on operational issues

The objective of this task would be for the DGSE to develop and issue a comprehensive and structured set of instructions on the operations of SOE pension funds, which will serve as the core of the DGSE's regulatory strategy. These instructions should be based on the implementing regulations issued by the Department of Pension Funds and the results of the analysis carried out in Task III.A.2 above, and should take into account the guidelines recommended in Chapter III.

Depending on the results of the analysis carried out in Task III.A.2, the DGSE may want to issue different categories of implementing instructions which, while based on the same general guidelines, will take into account the size, status and condition of various SOEs. Each set of implementing instructions should include a time frame which lays out the period within which SOE pension funds must comply to that instruction.

Implementing instructions should be prepared following a list of categories and topics determined by the Directorate General. The operational guidelines in Section B.2 of Chapter III can be used as a general list of categories for this purpose.

This task could commence at any time, but could not be completed until the Pension Funds Law implementing regulations have been issued.

Output/product: A comprehensive and structured set of implementing instructions governing SOE pension fund operations for the pilot group.

Task III.A.4 Develop DGSE Instructions on Reporting Requirements

The objective of this task would be for the DGSE to develop and issue implementing instructions on requirements for reporting by the pilot group of SOE pension funds to the DGSE and by the DGSE to the Minister of Finance. These instructions will be instrumental in determining the DGSE's ability to supervise SOE pension funds, and are therefore central to carrying out the supervisory strategy defined in Task I.2. Reporting requirements should be based on the implementing regulations issued by the Department of Pension Funds and the operating instructions defined in Task III.A.3 above, and should take into account the guidelines recommended in Chapter III.

The extent and types of implementing instructions on reporting will depend to a large degree on the reporting requirements contained in the Pension Funds Law implementing regulations. If these regulations require detailed and comprehensive reporting to the DPF, the Directorate General may be able to obtain most of the information it needs through the DPF.

As with the operating instructions, the reporting requirements for SOE pension funds should be established for a defined set of categories that will enable the DGSE to determine whether pension funds are following the operational instructions established in Task III.A.3 above. It is particularly important that the Directorate General be informed of any decisions made by an SOE that will affect the assets or liabilities of its pension fund.

In addition, guidelines should be established to define the reports and information about SOE pension funds that will be issued by the Directorate General. These reports should provide aggregate statistics and comparative figures on benefits, costs, and investment performance, for example. Reports to the Minister of Finance should be made on a regular basis.

Output/product: A comprehensive and structured set of implementing instructions governing reporting requirements for the pilot group of SOE pension funds and for the DGSE.

Task III.A.5 Review implementation plan based on the conclusions of this sub-phase

Once an analysis of the pension funds in the pilot group has been carried out and implementing instructions on both operational issues and reporting requirements have been issued, the Directorate General should review its implementation plan and revise it as necessary.

Output/product: If appropriate, a revised implementation plan for DGSE regulation and supervision of SOE pension funds.

Sub-Phase B: Implementation of Instructions on a Pilot Basis

Task III.B.1 Implement operational instructions

Once the implementing instructions have been issued by the DGSE, each pension fund in the pilot group should prepare a proposal explaining how it plans to manage the transition period and ensure compliance with all implementing instructions in the time frame set by the DGSE. The DGSE can advise and assist in this process, as necessary.

Output/product: Compliance with the DGSE implementing instructions regarding operational issues by all SOE pension funds in the pilot group.

Task III.B.2 Implement instructions regarding reporting by SOEs and DGSE

This task involves commencement of reporting by the pilot group of SOE pension funds to the Directorate General, based on the reporting requirements established in Task III.A.4 above.⁵ At this point, the DGSE should also begin producing and publishing summary and consolidated reports on this group of SOEs, also as defined in Task III.A.4.

Output/product: Regular reporting to the DGSE by all SOE pension funds in the pilot group, in accordance with the implementing instructions. Preparation and issuance of summary reports on SOE pension funds by the DGSE, in accordance with the implementing instructions.

Sub-Phase C: Implementation of Instructions at All Remaining SOE Pension Funds

Once the pension funds in the pilot group have implemented the DGSE operational and reporting instructions, plans should be made for all SOE pension funds to implement the

⁵ *Note: Reporting by SOE pension funds is dependent to a certain degree on an adequate management information system (MIS) linking SOEs to the Directorate General. This task is based on the assumption that the DGSE will move forward with its plans to install such a system. Without an adequate MIS, supervision of SOE pension funds by the DGSE could be extremely difficult.*

instructions. It may be necessary to make some adjustments to the instructions at this point, depending on the success of implementation at the companies in the pilot group.

Task III.C.1 Implement operational instructions

Same as Task III.B.1 above, except implementation is carried out by all remaining SOE pension funds.

Task III.C.2 Implement instructions regarding reporting by SOEs and DGSE

Same as Task III.B.2 above, except implementation is carried out by all remaining SOE pension funds.

E. Phase IV: Development and Implementation of Instructions for Small SOEs and Financially Weak SOEs

As stated in Section B.4 of Chapter III, small SOEs and financially weak SOEs should seriously consider alternatives to operating individual pension funds. Given the special needs of these funds, the DGSE should deal with them separately when devising its regulatory/supervisory program. This would be done in Phase IV of this implementation plan, which focuses exclusively on the design and implementation of instructions for the pension funds of small SOEs and financially weak SOEs.

Sub-Phase A: Development of DGSE Implementing Instructions

The DGSE should conduct an analysis of the two options presented in Recommendations #41 and #42: small SOEs and financially weak SOEs joining together in Employer's Pension Funds, or enrolling their employees in Financial Institution Pension Funds. A determination should be made on whether one or both options should be used, and implementing instructions prepared accordingly, covering both operational issues and reporting requirements. The steps described in Tasks III.A.3 and III.A.4 above could be followed.

Output/product: A specific set of implementing instructions, covering both operational issues and reporting requirements, for pension funds of small SOEs and financially weak SOEs.

Sub-Phase B: *Implementation of Instructions*

Implementation of the instructions developed during the previous sub-phase should be carried out, following the steps described in Tasks III.B.1 and III.B.2.

Output/product: Compliance by all small SOEs and financially weak SOEs with the DGSE implementing instructions regarding operations and reporting requirements.

F. PHASE V: Training and Human Resource Development Program

Training and human resource development activities could begin immediately, and could be carried out concurrently with the other phases of activity under this implementation plan. Development of a strong regulatory and supervisory system for SOE pension funds and efficient operation of that system by the Directorate General will require a comprehensive, targeted human resource development program. In addition, a training and human resource development program will be needed for staff at SOEs who are responsible for pension programs.

Sub-Phase A: *Design of Human Resource Development and Training Program***Task V.A.1 *Select DGSE staff responsible for the implementation plan***

Prior to beginning the process of developing an SOE pension fund regulatory and supervisory system, the Directorate General should select a team to oversee the day-to-day management of this process as soon as possible. Members of this team would be responsible for development and implementation of the regulatory/supervisory system, and would serve as the day-to-day counterparts for any consultants working with the DGSE. This team's composition, motivation, and understanding of its task will be critical to the success of this entire effort; without talented and dedicated DGSE staff focusing on the issues and pushing the process along, the complex and time-consuming task of developing and implementing a pension fund regulatory and supervisory system is likely to drift.

Output/product: A team selected by Directorate General and assigned to carry out this effort.

Task V.A.2 Design pension-related human resource development and training program for Directorate General staff

In addition to the team assigned to carry out the design and implementation of this work program, once the regulatory/ supervisory system is operational, the Directorate General is likely to need a broader group of professional staff to monitor and provide guidance to SOE pension funds on an ongoing basis (as described in Recommendation #43).

A program for human resource development in this area should be designed by the DGSE as quickly as possible. The staff described above should be selected and/or recruited, and a training program devised. Seminars should be organized to ensure that DGSE staff fully understand the new Pension Funds Law and its implications, as well as the DPF implementing regulations, once they are issued. Detailed, practical training on technical aspects of pension funds and on regulation and supervision should be provided. The staff could be sent overseas to work with regulatory/supervisory agencies in other countries, or specialists could be brought to Jakarta to provide hands-on training and coaching. A combination of international and local training programs is recommended. Consideration should be given to integrating the MOF Department of Pension Funds in any DGSE-level training program.

Output/output: Human resource development and training program for DGSE staff designed.

Task V.A.3 Design HR development and training program for SOE staff responsible for pension funds

SOE staff responsible for overseeing the management of pension funds, or for managing pension funds in the case of a few SOEs, are likely to also need substantial amounts of training and development. The Directorate General should assist the SOEs in developing human resource and training programs in this area. The DGSE's role should be limited to devising a training strategy and recommending a program design. The actual costs incurred in providing this training should be borne by the SOEs themselves.

The programs should include seminars to ensure that SOE staff fully understand the new Pensions Law and DPF implementing regulations, as well as seminars to introduce the DGSE operational and reporting instructions, once they have been issued. Other means of training could include overseas programs or local coaching or training programs taught by foreign or local specialists.

In many countries, training related to pension funds is carried out by a special training institute founded by the Association of Pension Funds. The DGSE should encourage SOE pension funds, as members of the Pension Funds Association, to promote and assist in the process of setting up a special training institute. This institute could develop and offer courses on all aspects of pension management and supervision. The Pension Funds Association should consider working together on this project with insurance companies or banks. In many countries, banks have proved particularly useful in this role, because they often have well-developed training resources and facilities which can be taken advantage of.

Output/result: A preliminary design for training and developing SOE staff responsible for pension funds completed and agreed upon by SOEs and the DGSE. If possible, a training institute established and operational, offering pension fund training programs for SOE staff, staff at other pension programs, and other relevant parties.

Sub-Phase B: Implementation of Training and Human Resource Development Program

Task V.B.1 Train DGSE staff responsible for this implementation plan

Once the implementation team is chosen, training should begin immediately. Training could be in the form of overseas programs, local "coaching" by specialists with expertise in various areas, or both. While a minimal amount of formal training may be necessary, it is expected that this team will learn on the job — most of their knowledge is likely to be gained in the process of carrying out this implementation plan, working directly with specialists who may be brought in to provide assistance.

Output/product: A series of basic training programs for the implementation team conducted, and the team in the process of carrying out the implementation plan.

Task V.B.2 Implement pension-related HR development and training program at the Directorate General

The HR development and training program designed in Task V.A.2 above should be implemented, including recruiting or selecting the staff members and providing all necessary training. This activity should take place within the DGSE's broader efforts to develop its human resource capability and function.

Output/product: DGSE pension fund regulatory/supervisory staff identified and trained, and carrying out the DGSE system for SOE pension fund regulation and supervision.

Task V.B.3 Implement HR and training program for SOE staff responsible for pension funds

The HR development and training program designed in Task V.A.3 above should be implemented by SOEs and, if possible, by a training institute founded by the Pension Funds Association. The Directorate General should provide assistance and advice to SOEs on training and human resource development issues, as needed.

Output/product: SOEs carrying out active program to train and develop staff who are responsible for pension programs.

Sarinah	Minhad Moefitje, Director of Finance
PT Jakarta International Hotel	Thomas Welford, Secretary Controller
PT Asuransi Jasa Indonesia	Amir Imam Poero, President Director
Yayasan Dana Pension Karyawan PT Asuransi Jasa Indonesia	G. Lasut, Ketua
PT Industri Sandang I	Sapei Prawiradilaga, Production Director
Yayasan Dana Pensiun PT Industri Sandang I	Arsana Manuaba, Chairman
Perum Perhutani	Various staff members

Insurance Companies

PT Taspen	Didi Achdijat, Director for Information System Development
PT Asuransi AIA Indonesia	S. Samuel Maurice, Vice-President and CEO Drs. Supardi, AVP & Comptroller Peggy Tanod, Group Manager Harry Diah
PT Asuransi Jiwasraya	Dr. Soekartono, Head of Investment Division Soepartono SH, Investment Division Dra. Murniati Firman, Financial Director Sapto Trilaksono, Vice President and Actuary

Capital Market Institutions

Jakarta Stock Exchange	Achmad Daniri, Director
Lippo Securities	John Mytton, Sales Managing Director
PT Person Finans Perdana (Investment Managers)	Firdaus A. Siddik, President Director Jane Vessey, Executive Director

LIST OF INTERVIEWS

Ministry of Finance**Directorate General of State Enterprises**

Subdirectorates for Information and Development ¹	Andung Nitimihardja, Head Sondang Gultom
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Directorate General of Financial Institutions

Directorate of Pension Funds	Indomen Saragih, Director Isa Rachmatarwata
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Directorate of Accountancy Guidance and Appraisal Services	Indra Soerjantoro
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BAPEPAM

Corporate Finance II Bureau	I Patu Gede Ary Suta, Head
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Other MOF Consultants

Harvard Institute for International Development	Yves Girard, Pension Fund Consultant Bob Heisman, Actuary and Pension Fund Consultant
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State Enterprise Pension Funds

PT Askindo (Asuransi Kredit Indonesia)	I Made Marka, Managing Director Djoni Rubiono Seroso Hs. Hendry Sidjedi Agus Suwito
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¹ Meetings took place prior to the organization's change from Directorates to Directorate General level. For this reason, the former title and unit name is used here.

Other Private Sector Companies

Learning International

Michael Griffin (Former Pension Fund Director
for LippoLife)

Price Waterhouse Konsultan

Leonard van Hein, Partner
Yetty Sulisty, Business Advisory Service
Manager

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