

REGULATORY FRAMEWORK FOR PRIVATE PENSION FUNDS

(TC-96-08-03-BR)

EXECUTIVE SUMMARY

BENEFICIARY AND EXECUTING AGENCY: Supplemental Pension System Secretariat (SPC) of the Ministry of Social Security and Social Assistance (MPAS) of the Federative Republic of Brazil

OBJECTIVES: The objectives of the project are: (i) to review the legal framework and regulations for the private closed supplemental pension system, and (ii) to strengthen the system's regulatory capacity as well as the supervisory and compliance monitoring functions of the SPC, the body that regulates and supervises the system.

FINANCING:

Modality:	Grant (Window I)
Recipient:	US\$1.2 million
MIF:	US\$1.2 million
Total:	US\$2.4 million

SPECIAL CONTRACTUAL CONDITIONS: The SPC will be required to formally designate a senior official from its senior management as operational coordinator for the project.

EXCEPTIONS TO POLICY: None.

I. COUNTRY ELIGIBILITY

A. Country eligibility

- 1.1 On February 9, 1995, the Donors Committee declared the Federative Republic of Brazil eligible for all forms of financing from the Multilateral Investment Fund.

B. Project eligibility

- 1.2 The financing for this project to review the regulatory framework for the pension system and to strengthen the regulatory capacity of the Supplemental Pension System Management Board (CGPC), as well as the supervisory and compliance monitoring functions of the Supplemental Pension System Secretariat, is consistent with the MIF's objectives of facilitating increased private investment and expanding and developing the private sector. By making regulation, supervision, and compliance monitoring more efficient, the project will bring transparency to the system. The experience acquired in implementing this program may also facilitate and spur similar experiences in other countries of the region.
- 1.3 The proposal is consistent with the financing criteria set out in Article 3, Section 2, of the Agreement Establishing the MIF, which stipulates among other things that financing may be granted to governments to support the development of financial systems through plans for reform of policies and legal structures for investment, establishing minimum prudential standards and boosting the capacity of supervisory institutions.

II. BACKGROUND

A. Frame of reference

- 2.1 Pursuant to Law 6,435 of July 15, 1977, the Brazilian government established an open and closed supplemental pension system. This "pension fund" system supplements the benefits provided under the basic pension system administered by the State through the National Social Security Institute. The new law made it possible to regularize existing situations and to guarantee a minimum retirement income so that pension recipients could maintain an acceptable standard of living. The system was also considered an excellent vehicle for encouraging internal savings to finance productive investment in the country.
- 2.2 For nearly two decades, the system has been functioning under the agencies established pursuant to Law 6,435/77 and the regulations issued by the Supplemental Pension System Management Board. This legislation was administered, however, in an extremely inflexible

manner that failed to keep up with the evolving dynamics of the Brazilian economy and society as new types of plans and funding schemes were being created.

- 2.3 The Supplemental Pension System Secretariat of the Ministry of Social Security supervises the Private Closed Supplemental Pension Funds (EFPPs) 1/, which account for most of the supplemental pension system. However, it does not have suitable mechanisms for monitoring and assessing the actuarial risks of the new plans and the quality of investments made with resources in the system. The many different types of plans, financing mechanisms, and management models now in use are experiencing very strong growth and the supervisory agency needs to adapt to this new reality in order to be better able to evaluate the risks and ensure their prudent management in Brazil's present socioeconomic setting.
- 2.4 For the system itself to evolve, the legislative framework and organizational structure of the supervisory, regulatory, and compliance monitoring bodies need to be reformed in order to permit: (i) more flexibility in developing benefit plans; (ii) greater security for plan members; (iii) greater transparency in EFPP operations; (iv) clear rules for evaluating the liquidity and solvency of the plans in terms of assets and from a financial and actuarial standpoint; and (v) a clear definition of the agents operating in the system.
- 2.5 In this scenario, the proposed operation will permit the development of a system that is transparent and essentially safe, making it possible to generate high levels of internal savings that would enhance the conditions for financing productive investment in Brazil. To achieve this objective, the project will include studies and changes to strengthen the structure of the Supplemental Pension System Secretariat, as regulatory and compliance agency of the EFPP system, thereby assuring its efficiency, safety, solvency, liquidity, and transparency.

1/ The system includes closed funds (Entidades Fechadas de Previdência Privada) [EFPP] under the supervision of the SPC/MPAS, which by the end of 1997 consisted of 354 funds and total assets of approximately US\$85 billion, and open funds which, because they are similar to insurance products, are supervised by the Superintendency of Insurance (SUSEP) and which by year-end 1997 consisted of only 38 companies with total assets of just over US\$3 billion.

III. THE PROJECT

A. Objectives and basic components

1. Objectives

- 3.1 The objectives of the project are: (i) to review the legal framework and regulations of the private closed supplemental pension fund system, and (ii) to strengthen the regulatory capacity of the CGPC, the regulatory body for the system, and other legislative bodies, as well as the supervisory and compliance monitoring functions of the Supplemental Pension System Secretariat (SPC) of the Ministry of Social Security and Social Assistance (MPAS), the body responsible for regulation and oversight.

2. Basic components

- 3.2 The following components will be included to achieve the proposed objectives. The scope of each component is summed up below:

a. Regulatory standards

- 3.3 This component will include: (i) reviewing the regulatory framework of private closed pension funds (EFPPs) in Brazil, preparing a proposal to modify the regulations and to provide the SPC with the organizational and legal structure needed to implement these regulations; (ii) reviewing and proposing modifications to practices and procedures for preparing and analyzing financial reports, for use by EFPPs and the SPC; and (iii) developing a new investment management model for investment funds.

b. Actuarial analytical modeling

- 3.4 This component will encompass: (i) the modeling of standard plans, defining the corresponding rules and actuarial reports as well as preparing proposed regulations for such plans and a manual of operating rules and standards, and (ii) developing a proposed model for preparing and analyzing actuarial reports and a methodology for assessing levels of solvency and risk for the benefit plans offered by the funds.

c. Integrated information system

- 3.5 This component will seek to develop and implement: (i) an integrated SPC data base that will be used to construct a new integrated version of the different modules of the system; (ii) an economic and financial module that will make it possible to provide off-site supervision of a fund's investment management; (iii) an actuarial module, to permit better monitoring of variations in fund liabilities; (iv) a new registry module for control of EFPP basic

data; (v) a new accounting module, that will permit more effective analysis and control of administrative transactions; (vi) a new compliance module to control, penalize, and track violations; and (vii) a new module for a protocol and tracking of processes.

d. Technical training and instruction for personnel

- 3.6 In this component, consultants will be hired to offer courses, seminars, and workshops to provide the SPC's technical and management staff with the expertise and training required to perform the new functions and to operate the new information systems to be brought on stream.

e. Technical coordination

- 3.7 There are plans to hire a consultant specializing in pension fund regulation and supervision to provide technical management for the project and coordinate the different components for purposes of ensuring timely and quality execution.

**IV. EXECUTING AGENCY, IMPLEMENTATION ARRANGEMENTS,
PROJECT READINESS, AND PROJECT BENEFICIARIES**

- 4.1 The Supplemental Pension System Secretariat (SPC) of the Ministry of Social Security (MPAS) will be the executing agency and the recipient of the assistance provided under the present operation. An analysis of this agency shows that it will have the resources and the institutional capacity for successful implementation of the project.

1. Implementation arrangements

- 4.2 The SPC/MSAS's Subsecretariat will be directly responsible for project execution. The SPC's senior management will be responsible for coordinating the operational aspects of the project (logistics and administration) and a consultant specializing in the areas targeted by the project, to be hired out of project funding, will be in charge of technical coordination of the operation (see paragraph 3.7).

2. Readiness of the project

- 4.3 The project is ready for implementation. A full description has been prepared for each of the activities planned for the different components together with the estimated cost and a timetable. The terms of reference have also been drawn up for all of the consultants who will be required for the program. Budgetary appropriations have been committed to cover all of the counterpart expenses anticipated and the physical and human resources on hand are sufficient to perform the tasks that the project will entail.

- 4.4 The program is expected to be completed in a timeframe of 24 months, including 18 months of effective work. The term for disbursement has been set at 32 months. The table below shows the estimated timeframe for each of the activities of the different components.

TABLE 1
SCHEDULE OF ACTIVITIES

	MONTHS																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1. Regulatory standards																		
- Proposed regulatory framework																		
- Proposals on accounting aspects																		
- EFPP investment management module																		
2. Actuarial analytical modeling																		
- Definition of standard plans																		
- Actuarial analytical and report module																		
3. Integrated information system																		
- Development of data base																		
- Economic and financial module																		
- Actuarial module																		
- Registry module																		
- Accounting module																		
- Violation tracking module																		
- Process tracking module																		
4. Technical training and instruction for personnel <u>1/</u>																		
5. Technical coordination <u>2/</u>																		

1/ Training and instruction will be given as the different phases of activity are completed.

2/ Technical coordination for the project will be provided during the 18 months of effective work.

3. Beneficiaries

- 4.5 Although the SPC/MPAS will be the direct and principal beneficiary of the operation, the greatest benefits will certainly go to EFPP plan members, inasmuch as all of the efforts involved are aimed at ensuring that the funds are solvent and yield an acceptable return.

V. COST AND FINANCING

- 5.1 The total cost of the project is estimated at the equivalent of US\$2.4 million, of which one half will be contributed by the MIF as nonreimbursable funding under Window I. The remaining US\$1.2 million consisting of local counterpart funding will be taken from the SPC/MPAS budget, which in turn comes from the budget of the central government of the Federative Republic of Brazil. The expenses to be covered out of the counterpart funding are consulting and related services (55%), any additional equipment that may be needed for the project including software (44%), and miscellaneous office supplies (1%). Expenses incurred in connection with premises occupied, use of existing equipment and remuneration for in-house staff involved in the project are not included.
- 5.2 A breakdown of the various components together with their expected costs is presented in the table below.

TABLE 2
COST OF THE COMPONENTS AND PLANNED ACTIVITIES
(US\$)

Months work	COMPONENT/ACTIVITY	MIF		MPAS		TOTAL	
	1. Regulatory standards						
4	- Proposed regulatory framework	120,000		19,600		139,600	
3	- Proposals for accounting aspects			51,800		51,800	
3	- EFPP investment management module		120,000	83,900	155,300	83,900	275,300
	2. Actuarial analytical modeling						
6	- Definition of standard plans	160,000		22,300		182,300	
3	- Actuarial analytical and report model	80,000	240,000	22,400	44,700	102,400	287,700
	3. Integrated information system						
3	- Development of data base	100,000		80,300		180,300	
6	- Economic and financial module	180,000		142,900		322,900	
6	- Actuarial module	180,000		142,900		322,900	
2	- Registry module	20,000		8,900		28,900	
4	- Accounting module	100,000		84,800		184,800	
4	- Violation tracking module	60,000		53,600		113,600	
2	- Process tracking module	20,000	660,000	17,800	531,200	37,800	1,191,200
18	4. Technical training and instruction for personnel		90,000		388,400	478,400	478,400
18	5. Technical coordination		90,000		80,400	170,400	170,400
	GRAND TOTAL		1,200,000		1,200,000		2,400,000

- 5.3 No equipment purchases are included in the MIF-funded costs. Contingencies are not included either, since these would be covered by the SPC with funds of its own in addition to the original commitment in local counterpart funding. The project expenses covered by the MIF resources will be limited to financing that will be needed to hire full-time and part-time consultants for two major sets of tasks: (i) research and technical development, and (ii) training for SPC personnel.

VI. JUSTIFICATION AND RISKS

A. Justification

- 6.1 The purpose of the reform of the legal and regulatory structure for the private closed supplemental pension system is to establish clear, consistent, and effective rules that make for greater transparency in benefit plans and EFPPs on the whole, through more effective control of operations and greater safety and solvency. This will raise confidence in the system and give it credibility in the eyes of existing and potential members and sponsors of funds, particularly in the national private sector, thereby producing a system with sustainable growth.
- 6.2 Building up the regulatory, supervisory, and compliance monitoring capacity of the SPC is an essential condition for fostering more effective monitoring and control of the system. To attain these goals, it will be necessary: (i) to train technical and management staff in all aspects of system activities, particularly actuarial analysis, so that the institution will have more qualified personnel to fulfill the responsibilities assigned to it by law; (ii) to develop and implement an integrated information system and data communications network to ensure proper monitoring of the entire private closed supplemental pension system by the regulatory body, particularly data on plan membership and resources guaranteeing that there are sufficient reserves to cover benefits and investments; (iii) to design an organizational structure in keeping with its institutional mission and to train a qualified management body in a manner consistent with the functions assigned to the SPC as the body responsible for enforcing the regulations issued by the CGPC and other legislative bodies as well as to establish a sector policy for the system in terms of transparency and acceptable levels of safety, solvency, liquidity, and risk.

B. Risks

- 6.3 Overall, the success of the program will depend largely on a firm commitment by the authorities and the technical staff of the SPC to ensure that it is carried out according to plan. In addition, to ensure that recommendations and proposals resulting from the

consulting work are effectively implemented, there will need to be provision for penalties for infractions of the eventual rules and standards.

- 6.4 Amongst the specific risks associated with the project are that there may not be enough counterpart personnel and that counterpart staff may not have the information-technology facilities required for the project. In an official letter received by the Bank in February 1998, the SPC indicated that the human resources and information-processing facilities are considered to be sufficient because the present installed hardware and systems capacity meets existing needs.
- 6.5 Another potential risk has to do with the capacity of the SPC to sustain or maintain on its own the improvements attained as a result of the project. Here again, although it is not possible to give any specific details of the SPC's future legal and administrative structure, or its eventual needs in terms of personnel and information-processing facilities, the SPC communication of February 1998 suggests that the federal government is presently moving towards the creation of special autonomous offices and bodies enjoying greater administrative and budgetary independence, a development that should enable the SPC to manage its needs and resources more effectively.

VII. PERFORMANCE CRITERIA AND EVALUATION OF PROJECT OUTPUTS

- 7.1 The evaluation of the performance and outputs of the project will be based strictly on timely completion and the quality of the different outputs expected from the activities to be carried out under the various components. These outputs are described in the logical framework, which is available in the RE1/F11 division technical files. The rate of advance of the project and its successful completion will be evaluated through an analysis of the semiannual progress reports and the final report which the SPC/MPAS will be required to submit to the Bank.

VIII. EXCEPTIONS TO POLICIES OR PROCEDURES

- 8.1 No exceptions to the policies and procedures in effect for operations of this kind are required for the project.

IX. CONTRACTUAL CONDITIONS

- 9.1 The Supplemental Pension System Secretariat will be required to formally designate a senior official from its senior management as operational coordinator for the project.

PROPOSED RESOLUTION

**BRAZIL. NON REIMBURSABLE TECHNICAL COOPERATION FOR LEGAL
FRAMEWORK PRIVATE PENSION FUNDS**

The Board of the Donors of the Multilateral Investment Fund

RESOLVES

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such agreements as may be necessary with the Federative Republic of Brazil and to adopt such measures as may be pertinent for the execution of the plan of operations referred to in Document AT_____, with respect to a nonreimbursable technical cooperation for legal framework private pension funds.
2. That up to the sum of US\$ 1.200.000 is authorized for the purposes of this resolution, chargeable to the resources of the Technical Cooperation Facility of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.