SUMMARY RECORD OF THE SECOND OECD CONFERENCE ON PRIVATE PENSIONS IN BRAZIL

SAO PAULO, 23-24 MAY 2002

The second OECD Conference on Private Pensions in Brazil organised under the aegis of the OECD Centre for Co-operation with Non-Members was held in Sao Paulo on 23-24 May 2002. The conference was hosted by the Secretariat for Complementary Pensions (SPC) of the Brazilian Ministry of Social Security and Assistance and the Regulatory Agency for Open Funds (SUSEP) of the Ministry of Finance, with co-sponsorship by the International Pension Foundation, and local support from Fundaçao Getulio Vargas, Brazil.

Spurred by rapid demographic changes and facing problems of unsustainable fiscal deficit, many Latin American countries have considered to reform their public pension systems in the past ten years by substituting and/or complementing, to different degrees their pay-as-you-go systems by fully funded private pension schemes. In line with the experience of other countries, the Brazilian government has – since 1997 - actively pursued pension reform in order to reduce the fiscal deficit and inefficiency of the current social security scheme and to ensure greater equity of pension provision and facilitate the sustainable growth of funded pension plans. The second OECD conference was organised to continue the high-level policy dialogue started last year in Rio de Janeiro on private pension reform in Brazil, an area identified by the Brazilian government as a key priority of social policy. Leading experts from OECD member countries and Brazilian high ranking governmental officials, representatives from the principal insurance companies and private pension industry were brought together to share their experiences on this policy domain.

The discussion focused on the priority issues identified by the Brazilian authorities in light of further modernisation of the country's private pension system; notably, options and challenges for improving the regulatory and supervisory regimes for private pensions pension plan. During the meeting the regulatory and supervisory practices in Brazil were compared to those in selected OECD countries. The dialogue was focused on topics of particular relevance including pension plan governance, consumer protection, investment regulation and funding and accounting rules for pension entities and plan sponsors.

The conference was opened by the Minister of Social Security and Assistance of Brazil, Mr. José Cecchin; the Dean of Fundaçao Getulio Vargas, Mr. Francisco Sylvio de Oliviera Mazzura; the Chair of the Conference, Mr. Ambrogio Rinaldi and the Secretary of the OECD Working Party on Private Pensions, Mr. Juan Yermo. In the introductory speech, the Minister confirmed the strong commitment of the current government to continue public sector pension scheme reform along with creating a favourable regulatory environment for the development of private pension funds. Recognising the relevance of pension funds in economic stabilisation, the governmental efforts concentrated on establishing a well-designed and transparent pension legislation for both private and governmental pension funds, reinforcing the surveillance of markets by supervisory authorities, encouraging improved governance within the financial institutions and enhancing consumer education. The Minister emphasised the Brazilian government's continued reliance on the sharing of other countries' experiences and voiced his appreciation of the OECD's assistance efforts.

Session 1: Options and Challenges for the regulatory and supervisory regime for pension system

Entailing a major transformation in the financial markets, consolidation within institutional sectors and convergence of financial service providers have complicated the supervision's task and have resulted in a restructuring of the financial supervisory function in many countries in recent years. Due to the complexity of the corporate structure and the inter-sectoral linkages, the supervisors encounter increasing difficulties in overseeing on a purely institutional/structural basis the activity of financial conglomerate that centralise their internal controls, risk assessment and management. Emergence of new challenges, notably the lack of transparency of large financial conglomerates stemming from intra-group exposures, contagion jeopardy and more complex risk profiles, increase the need for enhanced regulatory and supervisory coherence within major financial sectors and has induced certain countries to introduce consolidated regulatory and supervisory regimes. It was underlined in the presentation of the OECD expert that the design of the regulatory and supervisory regimes should allow the objectives of the supervision to be attained efficiently and effectively while keeping the regime flexible and adaptable both to changes in financial markets and the structure of regulated entities.

The issue of consolidation of pension entities' regulatory and supervisory authorities is on the political agenda in Brazil due to the fact that the closed and open pension funds which are constituted mainly by insurance companies are regulated and supervised by two different institutions. The proposal has been submitted by the government for the establishment of a new unified regulatory agency in charge of the supervision of both closed and open funds with a broader and more pertinent mandate than the current structure that has created a duplication of specialised functions (such as auditing, actuarial analysis, credit rating and insurance supervision). According to the Brazilian expert the major shortcomings of the existing regulation are the (1) insufficient vesting and portability rules in closed occupational pension schemes; (2) insufficient tax incentives for individual and employer-sponsored retirement plans; (3) rigid investment regulations and (4) poor disclosure.

Sessions 2 and 3: Structure and practice of pension supervision

The session covered the modalities of selected countries' supervisory oversight over private pension schemes. The structure of supervisory authorities, key supervisory functions and scope of operating procedures were examined in-depth. The OECD expert traced the development of supervisory practices in three OECD countries of Central Europe; namely, Hungary, Poland and the Czech Republic. Both Poland and Hungary have established integrated prudential financial supervisory authorities covering - in the case of Hungary - all financial sectors and - in Poland - the insurance and private pension sectors. Exploitation of positive economies of scale, more efficient, risk-based allocation of supervisory resources, more effective utilisation of supervisory human resources, improved accountability and higher profile of supervisory work were identified as the main reasons behind the move toward an integrated financial supervision. The expert from Hong Kong continued the theme, presenting the supervisory techniques of the recently created Mandatory Provident Fund Schemes Authority. The focus was laid on on-going monitoring and oversight of trustees characterised by systematic and rigorous on-site inspections and audit following risk-based approach. In the United States, in contrast, given the large number of plans and plan sponsors and the limited resources available to the government, it was argued by the expert that the supervisory system heavily relies on voluntary compliance and prevention of violations ("self-correction process") by plan sponsors and private-sector pension professionals who advise and assist plan sponsors to comply with the legal requirements. The achievement of greater efficiency, credibility and transparency of supervisory agencies were identified as the major concerns of the Brazilian policy makers. This problem affects primarily the supervision of closed funds lacking adequate incentive mechanisms to ensure compliance of the pension funds with basic prudential and protective rules. While the major efforts are concentrated on both off-site surveillance and on-site inspection, the supervisory authorities are promoting the development of external audit over pension fund activities that would decrease the burden of governmental supervision. More efficient measures to ensure the adequate information disclosure of investment performance, fee levels, portfolio allocation and regular reporting requirements are being considered by the supervisors of both closed and open pension funds.

Session 4: Pension Plan Governance

The establishment of effective pension plan and fund governance in order to best protect the interest of plan members and beneficiaries and ensure the highest degree of retirement security is an integral part of the overall pension reform process in Brazil. The new regulation has been recently introduced in Brazil introducing the basic principles of good governance adopted across the OECD countries. This include responsibility in pension fund operation and oversight, accountability and suitability of the parties involved in the pension fund management process, establishment of appropriate internal control over fund performance and proper and timely disclosure of information. The Brazilian experts shared the view that along with regulatory incentives for the pension fund governance there should be an appropriate supervisory control mechanism covering all organisational and administration procedures ensuring that the management objectives are aligned with those of the shareholders. It was underlined that a key factor in improving the financial security of the pension system consists of setting up disclosure procedures for members (especially where individual choice is offered) to enable them to monitor the fund management. The US expert underlined that the full and timely disclosure of information on the financing of entitlements, investment performance, levels and structure of fees, rights and obligation of parties participating in managing the pension plan has proved to be essential to increase the awareness of pension scheme members of the expected value of their retirement benefits especially in the wake of the recent Enron scandal. In addition, there was a broad consensus among the experts on the importance of developing a meaningful and targeted programme of financial education of pension plan participants and making available professional advice and counselling consumers on financial products and investment decisions.

Session 5: Investment Regulation

The session commenced by a discussion on the establishment of new guidelines for investment by pension funds in Brazil that have been adopted as part of the governmental measures that encourage rationality and credibility within the pension system. These investment regulations were qualified by the Brazilian experts as the most modern and thorough ever published. The introduction of the new investment rules that followed a debate amongst all interested parties of the private pension community, pursue three main objectives: encouraging transparency and safety of investment management; achievement of greater diversification and flexibility of investment instruments permitting to maximise investment returns and encouraging migration from defined benefit plans to defined contribution plans. The new investment regime was characterised by the availability of a broader scope of securities eligible for investment (notably, investments in variable income assets are subject to higher limits), providing more freedom of choice for investment managers and greater asset diversification. Another innovation was the adoption of qualitative criteria for the allocation of resources on fixed and variable income aiming to strengthen the responsibility of asset managers on the choice of securities and encourage more accurate and precise evaluation of risks. Despite the measures taken to diversify asset allocation, the new law still does not permit investment in foreign securities. Investment of pension assets abroad is likely to stay on the political agenda in the coming years as although it could further improve the flexibility of asset portfolios, it may also introduce unknown risks to Brazilian fiduciaries. Much emphasis has been placed on the discussion of asset management and procedures for assessing investment risk: it became mandatory to hire technically qualified asset managers and custodians and for a risk classification agency operating in the country to make an evaluation of the assets. Moreover, recently adopted standards regarding good corporate governance practices complement changes introduced by the new investment regulation. The OECD expert highlighted the crucial role of appropriate governance infrastructure in investment performance. While the process-oriented nature of the prudent person rule requires good governance, pension plans operating in a quantitative environment such as Brazil should also greatly rely on a plan's governing body to make sound investment decisions in order to optimise investment performance for the plan.

Session 6: Funding and Accounting Rules for Pension Entities and Plan Sponsors

The last session focused on the impact of funding and accounting rules on occupational pension provision. An appropriate level of funding is a key element in defined benefit schemes for the long-term security of pension rights. The adequate reserves depend on crucial financial and demographic assumptions that include: the rate of interest used to calculate the present value of future pension liabilities; investment returns; inflation and wage growth and future mortality, termination and disability rates. Asset valuation was identified as another important factor to be used to measure pension liabilities. The OECD expert focused on defining appropriate funding vehicles and analysed circumstances when a funding vehicle is desirable and efficient. The advantages of a funding approach include – in addition to the enhanced security of plan beneficiaries - the tax effectiveness (tax exemption of company and employee contributions and tax sheltering of investment income). The expert also addressed the potential shortcomings resulting from funding requirements such as the hindering of the fulfilment of the employer's cash flow needs; requirement of a higher internal rate of return and resulting poor choice of investment vehicles. Much consideration has been given to development of adequate and flexible regulation as regarding minimum funding standards in pension funds. Regulation needs to specify appropriate valuation rules, mortality tables and discount rates and the appropriateness of the assumptions used need to be verified by actuarial reviews. Finally, it is essential for the plan sponsors to develop, implement and monitor a corporate funding strategy in order to educate the company management on the details of the actuarial calculations. The expert also highlighted the objectives of various accounting standards that lead to a level playing field; comparability across different companies and a single set of meaningful accounts.

In Brazil, where private pension plans are mainly based on occupational defined-benefit schemes, the ensuring of adequate funding of pension liabilities was identified as one of the major concerns of the Brazilian regulators. Although the regulation imposes the requirement for minimum funding levels it has not designated until recently the methodology for their calculation and the corrective actions to address any perceived deficiency in funding levels. The new amendments to the regulatory framework require full funding of the projected benefit obligation and establish actuarial criteria in biometrics, demographic and financial estimation as well as regular actuarial audit taking into account analysis of hypotheses, financing methods including levels used in the elaboration of the actuarial evaluation of the benefit plans.

Concluding remarks

The Second OECD conference on private pensions in Brazil was considered a great success by both the OECD and Brazilian participants. The meeting allowed active and open exchange of views between Brazilian experts from two regulatory authorities and market representatives on key pension policy issues, which were also examined, in a broader international context by the leading OECD experts. There was high-level political support from the part of Brazilian policy makers to continue and broaden the co-operation with the OECD. In this respect, specific reference was made to the relevance of the new meeting and conferences to be organised in the framework of the OECD CCNM Brazilian program and through the International Network of Pension Regulators and Supervisors.