



PREVIDÊNCIA SOCIAL

SUPERINTENDÊNCIA NACIONAL DE
PREVIDÊNCIA COMPLEMENTAR - PREVIC

PREVIC

**Best Practices Guide
for Pension Funds**





PREVIDÊNCIA SOCIAL

NATIONAL SUPERINTENDENCE
FOR PENSION FUNDS

PREVIC

BEST PRACTICES GUIDE FOR PENSION FUNDS

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EXPEDIENT

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PRESENTATION

After years of work and dedication to the Private Pension issues, we are pleased to be able to celebrate the sector growth in our country.

By the way, we are proud of our social security design – comprising the Private Sector (RGPS), Government Workers (RPPS) and the Private Pension Systems (RPC). The social coverage of RGPS reaches 55.36 million Brazilian citizens, the network of agencies is being widened in more than 60%, assuring more comfort to the insured people, rights are recognized automatically and benefits are granted within up to 30 minutes.

The search for excellence in the Brazilian social security system - goal of Luiz Inácio Lula of Silva government – takes place in the same way as in the Private Pension System. In the first semester of 2010, the National Superintendence for Pension Funds - Previc set up the Annual Supervision Program (PAF) and approved the pension funds financial education programs of 8 pension funds and 25 benefit plans.

The payment of Supervision and Control Fee (Traffic), instituted by Law no. 12.154/09, was enabled by electronic means. It was approved an instruction which regulates the use of Behavior Adjustment Term (TAC), a public administration instrument, which is used to adapt procedure to the legislation and to public interest.

Elaborating the Guide, PREVIC is aligned to the international practices. This document has the purpose of guiding pension fund managers, members, retirees, sponsors, and also the Previc staff in what regards to the management of the system.

The Guide is divided into essential topics: governance, investments, actuarial liability and risk management, besides Previc's recommendations and determinations to the system. Some of the issues of specific legislation are also listed.

Other Guides, with deepened subjects on good management practices by pension funds, will follow this guide. With this guide, we intend to diffuse general guidelines aiming to strengthen the Brazilian private pension system and also defend and guarantee the pension funds members benefit.

Carlos Eduardo Gabas
Ministro de Estado da Previdência Social

PREVIC

BEST PRACTICES GUIDE FOR PENSION FUNDS

INTRODUCTION

- 01** This Best Practices Guide, the first of a series that will be elaborated by Previc, is intended to guide pension funds managers, members, retirees, sponsors, and their staff to manage the pension funds day-by-day. Thus, Previc will be contributing to the strengthening of the system.
- 02** Another purpose of this Guide is to provide a general guideline on some issues of specific legislation of the occupational system. It's important to point out that the guide is only an interpretation of some relevant points of the legislation made by the supervisory body, neither being exhausting nor comprising all rules and could be altered due to possible changes in the current legislation or of other evolutions in its interpretation.
- 03** The State action, at this time, exceeds the role of supervision. Previc is committed to promote the use of good management practices, so that, once carried out in a careful, ethical and diligent way, these practices have a focus on the risk management and the full exercise of fiduciary duty.
- 04** The Guide will be developed in modules and will approach the best practices related to the administration of pension funds, being divided into four main topics: governance structure, including issues related to the selection and professionalization of the technical body; investments; social security liabilities; and management of risks. This first volume provides general guidelines on each item, and it just introduces the subjects that will be deepened in future editions.
- 05** Previc motivates the users of this Guide to search for an increased understanding on the issues of this document, in the legislation in force, as well as in the national and international bibliography. The use and interpretation of this material is of the full responsibility of pension funds and their managers.
- 06** The texts can be fully or partially reproduced without alteration, and their use is strictly personal or organizational and non-profitable. This guide is protected by laws of copyrights.

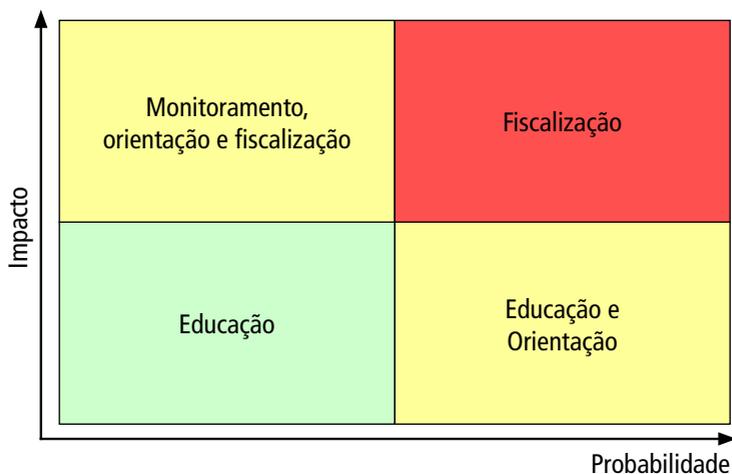
RISK BASED SUPERVISION

07 The role of the supervisory body is to assure that the pension funds management ensures the members' rights such as the payment of benefits as contracted. Accordingly, Previc intends to act in three ways:

- / Educating and providing the pension funds managers the management guidelines;
- / Guiding and recommending actions to be taken by pension funds during the on-site supervision; and
- / Determining actions or punishing the person in charge that persistently fail against the members' and retirees interests.

08 The following figure illustrates how Previc will act using the risk based supervision approach, due to the probability of occurrence of risk and impact caused by it.

Picture 1 – The supervisory body action using the risk based approach .



Fonte: Banco Mundial, 2010.

09 Previc's supervision approach will depend, therefore, on the incurred risks and on the management quality of these risks accomplished by the occupational pension

funds (EFPC). In that way, instead of punishing, Previc will encourage and promote the use of the best management practices. The Behavior Adjustment Term (TAC) is an example of the new approach.

The Behavior Adjustment Term (TAC) is an instrument used in the Brazilian public administration with the purpose of promoting behavior adaptation considered as irregular by legislation or contrary to public interests. The introduction of TAC in the pension system searches the adaptation of behaviors to legislation, and it can be proposed by any interested party, natural person or legal entity, before the supervisory body issues a fine.

The application of TAC refers to the occasions in which it's possible to correct the irregularity by means of adaptation of certain practice to the legal principles and of regulation in force. The Term can only be signed when there is no financial impairment to the pension fund or to the plans, unless the proposal includes the full compensation of the impairment. TAC can only be made feasible if there has not been, in the last five years, the signature of another Term regarding the same violation on the non-compliance with the term signed previously by the same interested parties. In addition to that, the EFPC should divulge TAC to the plans' members and retirees.

10 The introduction of this Guide is directly related and aligned to the guidelines of Risk Based Supervision (RBS), methodology that, gradually, is being put into place by this body. RBS, successfully adopted in many countries, changes the conditions of supervisors' work and modifies the way that pension funds interact with inspection teams. Besides, the RBS encourages an important culture shift in the work routine, of management and following-up from the supervisors and supervised ones that add efforts to defend and guarantee the members' benefits of the occupational system.

RBS verifies the exposure to risks and to the controls exercised on them, acts prudently on the origin of risks and induces to a

pro-active management of the pension funds. The analysis and evaluation of adversities and opportunities, observed in future sceneries, contribute to forming a wide vision of the occupational system and the environment it's inserted to, aiming, this way at the system's stability.

- 11** The RBS implementation objective in the supervisory body and in the occupational system is to apply its resources more effectively, identifying the biggest risks and acting pro-actively to minimize the negative impact on the pension funds members' benefits.
- 12** This new paradigm will be followed by an efficient education process that needs to reach the pension funds managers and members. The international experience shows that, besides the verification of adherence to regulations and rules, the supervisory bodies are also devoted to the education of the ones in charge of the management of pension funds and the promotion of pension schemes. The initiatives in this sense result in improvement of global results, with consequent and perceptible increase of profitability of assets and reduction of losses from risks intrinsic to the management of benefit plans. The managers' education process will evidence the importance of internal controls and the management of risks for the main mission success of benefit plans: to guarantee the payment of the pension members.
- 13** The financial education programs executed by the pension funds complement the efforts in the search of management excellence. Mmbers, duly educated and informed, are introduced as the ones that demand quality in the management of their benefit plans.
- 14** The Best Practices Guide is an important tool in the process of education and change of management approach by compliance with a risk management model. This change presents a big challenge: gather important and relevant information for all pension funds, regardless the size, the management process – in-house, outsourced or mixed -, the benefit plans arrangements, the regional differences, the sponsorship type or any other particularity.

// GOVERNANCE

- 15** Previc sees the pension funds trustees as the supervision front line of pension funds

that share the common interest of sustainability of the occupational system.

- 16 The minimum governance structure of a pension fund, comprises, according to the legislation in force, the Advisory Board (Conselho Deliberativo), Audit Board (Conselho Fiscal) and the Executive Board (Diretoria Executiva). The EFPC may constitute other instances of decision and advice, such as decision-making councils (investments, risks, among others), observing its size, the number plans and sponsors, as well as the nature of its sponsorship (public or private).
- 17 It's desirable to search for the maximum of representativeness in all instances, assuring the participation, whenever possible, of representatives of all plans, sponsors and members. The relevant decisions that cause impact to the pension fund or plans management should be taken, priority by collegiate bodies.
- 18 It's also up to EFPC to guide and disclosure to their members, the selection process of representatives of boards and committees, even when it's not done through electoral process. It's important to explain the board trustees and the committees' members which are their assignments and responsibilities, in the interests of the plans and the members, pointing out that the pension fund main objective is the payment of members' benefits.
- 19 The pension funds should evaluate the convenience and feasibility of creation of an ethical and behavior code, assuring its wide divulging to trustees and employees, contributing, this way, to its real execution. It's recommended that the code foresees rules of relative confidentiality regarding data and information which these professionals have access to when performing their functions.

The Advisory Board is the maximum instance of an EFPC and has, in the pension funds ruled by Complementary Law no. 108, of 2001, a maximum number of six members, observing the parity among representatives of participants, retirees and sponsors. The plan statute can foresee the composition of committees aiming at performance of representativeness of sponsors, members and retirees in their respective plans managed by the EFPC. It's important to observe the criteria, conditions and compositions for EFPC ruled by the Complementary Law 109, of 2001.

20 The Advisory Board can share, but cannot delegate, with committees responsible for the management of each plan, part of its assignments, related, for instance, to the approval of the investments policy and of the actuarial assumptions. It's up to the Executive Board to be the main agent in the definitions of policies and general strategies of the entity, as well as their periodic revision.

The Audit Board is the EFPC's internal control body and has, in the entities ruled by the Complementary Law no. 108, of 2001, at most four members, observing the parity participation among sponsors, members and retirees. It's up to the Audit Board to elaborate six-month reports which point out the opinion on the sufficiency and the quality of internal controls regarding the management of assets and liabilities and the budget execution. It's basic to observe the criteria, conditions and composition for the EFPC ruled by the Complementary Law 109, of 2001.

21 The Audit Board should undertake the responsibility on the entity's management effective cash control, alert on any deviation, suggest and indicate steps to be taken for the management improvement, besides issuing conclusive opinion on the entity's annual accounting statements. The Board choosing the hiring of specialized services, for its assistance should check the qualification and experience of the outsourced companies and professionals, as well as to assure that there is not conflict of interests among the service providers.

22 It's important to establish clearly in internal by-laws the operation rules of constituted boards and committees. The schedule of meetings, previously set, allows the members of boards and committees to program and organize their participations. The agenda and subjects need to be published in advance, in a way to allow the members' effective participation.

The Executive Board is the body responsible for the entity's management and has at most six members, whose form of composition and mandate, if applicable, should be foreseen in the entity's by-laws. It's basic to observe the criteria, conditions and composition for EFPC ruled by the Complementary Law 109, of 2001.

23 The Executive Board should perform its assignments in compliance to the management policy set by the Advisory Board. The communication to trustees board, sponsors and pension members is among its main assignments, pointing out that the information should be rendered in a regular and immediate basis. The management transparency adds value to the work accomplished and has positive impact on the plan s' results.

The communication and disclosure of reports to board of directors, sponsors and pension fund members should be made in a clear and accessible language, using proper means, with information on investment policies, actuarial assumptions, the economical and financial statements, as well as the costs incurred in the management of benefit plans. The EFPC should also inform, whenever requested by the interested parties, the situation of each member in relations to his/her benefit plan.

24 It's desirable that all board members have college degree. Irrespective of the graduation, they should have experience in matters related to the occupational system, holding technical and managerial competence with the complexity of the performed functions. Those professionals should perform their activities with good faith, loyalty and diligence, observing the principles of safety, profitability, solvency, liquidity and transparency. They should also care for the maintenance of high ethical standards, adopting practices that guarantee the compliance of the fiduciary duty in relationship to the benefit plans members

25 The board members activity should be performed on behalf of the benefit plans and the entity, avoiding that it's made on its own behalf of the group's, preventing potential conflict of interests. The board members, irrespective of indication or election, after being vested to the respective positions, start representing the entity and the benefit plans. Those requirements are also applied to the members of settled committees and intended to perform specific management of benefit plans.

26 It's up to the board, committees and management members, the constant search for promoting his/her education and permanent technical updating, aiming at increasing the contribution quality of each one of them in the discussions and deliberations.

27 The pension funds can also evaluate the convenience and viability of creation of an area of internal auditing. This body, when existing, plays an important role that includes the evaluation of internal controls. It's expected that this auditing is directly reported to the Advisory Board or to the entity's maximum official. Those auditors, in the execution of their activities, should verify the adaptation of rules and internal manuals to the routines accomplished by entity's several areas. Thus, the auditing can propose the implantation of processes, routines and controls that seek improving the management, as well as to suggest the revision of regulations, by-laws, rules and manuals. The internal auditing work can be replaced by the hiring of an external auditing, that performs the task in an independent way from the accounting auditing.

28 The assignments, the responsibilities and the competences of the entity's management instances should be set forth in internal rules, approved preferentially by the Advisory Board. The competence rules should consider the segregation of functions, that consist of separation among the functions of authorization, approval of operations, execution, control and accountancy, so that an entity's instance or employee does not start and conclude all stages of a same process. The segregation of functions and the clear definition of competences contribute to reduce risks inherent to the management.

29 The implementation of an effective management policy in the pension funds should take into account the aspects such as the process institutionalization and documentation. Manuals and rules, discussed internally by all the ones involved in the processes and later approved, add safety to the management, allowing the routines and activities to be just executed not only by its person directly in charge, facilitating the verification and auditing. This procedure contributes significantly to reducing risks, mainly, the operational ones. Those documents should be implanted immediately after the approval by the legal instances and periodically reviewed. The wide divulging of the documents to all entity's employees and hired third parties is part of the manuals' implanting process in the part which affects them, so that they can understand the policies and procedures regarding their activities and responsibilities.

30 The description of processes should include the definition of information flow between the statutory bodies and those settled by each entity. The information volume, form, periodicity and content need to be enough for the best decision taking and supervision.

31 A financial education program dedicated to board members, employees, sponsors, and pension members has positive effects on the management quality. Board members and employees start having abilities and knowledge necessary to the performance of their functions. Pension fund members acquire useful tools for the planning and control of their economical and financial life and they qualify themselves to the exercise of inspection and following-up their own benefits.

A financial education program should comprise the three levels recommended and consolidated in international guides of good practices: information, formation and guidance. The communication to members, put into first level, should, whenever possible, exceed the minimum content set forth by the legislation. The disclosed data should be interpreted so as the members understands the economical, financial and equity statements of their benefit plan. The clear and adequate language to the users' knowledge level should translate the technical terms applicable to the occupational system to facilitate the understanding by the users. The amount and quality of information received by the members should be enough to its aware financial decision making.

32 With the implementation of financial education programs, the board members can assure that the benefits and the offered or recommended services will be appropriate to the needs, interests and the objectives of the benefit plan members.

33 It's recommended that the entity analyzes the viability of creating an ombudsman or communication channel with employees, sponsors and pension fund members, as a way of organizing and following-up the reception of requests, questionings, accusations and representations.

34 It's important, to the entities that chooses for outsourced services, to know the internal structure of service providers and the people that execute the tasks, in order to guarantee that the good practices described herein are also observed by them. It's also recommended the periodical evaluation of the service provider's work (trust, asset management, actuaries, law offices, auditing and consultancy). The hiring of specialized services doesn't transfer the board responsibility assigned to them by the legislation in force.

INVESTMENTS

- 35** The investment policy is an important tool of the management planning of financial assets and should be elaborated observing the requirements of each benefit plan, aiming to match profitability needs and cash flow with benefit plans projections. In short, the investment policy needs to be guided by the actuarial liabilities: it's advisable to perform management studies of assets and liabilities to be reviewed and updated periodically.
- 36** The benefit plan arrangement, its maturation level, its specificities and the characteristics of its obligations, as well as the micro-economic scenery, determine the following guidelines of investments: the result goals of benefits plan and application segments; the allocation of resources to several segments; the maximum limits of application in each segment and assets; the indexers and maturity period of investments; the choice for assets having or not amortizations or payment of periodic interests; among others. Thus, it's expected that the investment policy is, in many cases, more restrictive than the resolutions of the National Monetary Council (CMN).
- 37** The Statutory Administrator Technically Qualified (AETQ), responsible for the investments of benefit plans, should be one of the members of the Executive Board. It's possible to indicate an AETQ for each application segment. The legislation in force determines that, up to December 2010, AETQ is certified by an institution of recognized merit by the finance market.
- 38** The assessments and the controls of investments should focus the operational, legal, systemic, market, credit and liquidity risks, as well as the segregation of management functions, administration and clearing. The board members need to be attentive to possible conflict of interests existing among the several service providers and the parties involved in the operations.
- 39** Regarding the management system and control of risks, it should be pointed out that it needs to be adapted to the entity's size, to the complexity of carried out operations, to the benefit plans arrangement and to the form chosen to the management of assets – in-house, outsourced or mixed. The models of risks, duly adapted to the reality of each entity, should be checked periodically and tested, and it can also be validated by third parties specifically hired for this purpose.

- 40** For entities having their own asset management, it's recommended to create a investment committee, in advisory or decision-making instance, comprising members with capacity and technical knowledge enough to guide in the application of the entity's resources. As the statutory bodies, the committee should have internal by-laws with rules and procedures related to its operation.
- 41** The rules applicable to the management should establish the competences for accomplishment and approval of operations, by range of value or relevance, so that the most representative investments are approved by the entity's superior instances (Advisory Board or, as the case may be, the Executive Board).
- 42** It's up to the entity, to hire outsourced management of its assets to officially establish the hiring criteria and procedures and following-up of these services. It's advisable to disclose this criteria to the entity's statutory bodies and to all competitors.
- 43** The managers, after legalization the service rendering agreement and the legislation awareness statement applicable to the entity's investments should appropriately follow the received mandate, in addition to stating the full knowledge of the legislation applicable to the investments of benefit plans. The agreement should establish in full detail, at least, the following points: the base profitability targets; the requirements of analysis and risk control; the limits of allocation, concentration and exposure to the risk to be observed; the allowed operations; the use of derivative; the frequency and quality of reports; the periodicity and form of management evaluation; the goals of profitability; the taxes payable; the agreement term; and rights and obligations of the parties.
- 44** It's up to the board members to evaluate and recognize the regulations of investment funds previously to the allocations, identifying the risks inherent to the operations provided in the regulations, verifying the correct classification of quotas or assets invested by the funds in the several application segments, as well as the adaptation to the effective ruling and to the investment policy of the benefit plan.
- 45** The clearing service, responsible for flows of payments and receipts regarding the carried out operations and for the guard and verification of asset existence can be centralized. The clearing service rendering agreement should establish the periodicity and the quality of managerial and analytical reports, the description of other services to be rendered, the costs of services and the party's rights and duties.

- 46** The negotiation between the entity and its service providers can include, in the agreements, clauses on the penalties and conditions for premature rescission, when verifying the mandates non-compliance.
- 47** The verification of the economical and financial balance of benefit plans depends on the specification of assets, in other words, it's necessary that the entity searches directly or by means of its service providers, appropriate assessment models. The evaluation form should follow the best practices of the financial market in the search for fair price, also considering the benefit plan modality.
- 48** Negotiations in electronic platforms and in stock exchange are recommended, since, in those environments, the prices of assets are more transparent and they come close to the real market value. Those negotiations collaborate significantly to the quality of assessment models.
- 49** It's pointed out that the management outsourcing does not result into transfer of the responsibility to board members.
- 50** Loans to pension funds members, when provided in the benefit plan investment policy, may require a specific control system. The operations with members should be signed in rates over the actuarial minimum and contain guarantee clauses over the contracted value, including insurance.
- 51** In multisponsor entities, it's additionally advisable; to implement the real segregation of assets, so that each benefit plan has its equity easily identified, preventing forming profiles in the benefit plan. The segregation widens the legal safety and integrity of assets of each plan, facilitates the control of combination of assets and liabilities, and simplifies the process of change of ownership in eventual occurrence of management transfer or any other event of restructuring of benefit plans and entities.
- 52** The benefit plans assets also include the normal and extraordinary contributions converted to the plan, and, as the case may be, the rights arisen from debts, contracted or not, with sponsors. The contributions should follow what's been established in the costing plan, and the monitoring needs to verify the payment of duties owned due to the delayed payment, including judicial collection.
- 53** It's advisable that the debts with the sponsors are converted into formal agreements that contain the updating clauses of values and of real guarantee that

covers the debt total value. It's basic that the periods of amortization and agreement termination are compatible to the financial needs of the benefit plan. The agreement should foresee the succession of obligations in a society restructuring occurrence which affects the sponsors. Additionally, such instrument needs to be registered in the registry office of documents.

SOCIAL SECURITY

The actuarial assessment has the main objective of dimensioning the value of mathematical reserves, social security funds and other commitments of the benefit plan, in order to establish the right cost plan. The management of liabilities of the benefit plans comprises the management of solvency and the financial balance.

- 54** The legislation in force explains the direct responsibilities in the actuarial assessment process. However, these direct responsibilities, it's important that the board members, aiming at the appropriate compliance to their roles, participate and undertake the basic function of several subjects involving the actuarial evaluation and the management of social security liabilities.

The manager in charge for the benefit plan (ARPB), appointed by EFPC among the members of the Executive Board, is the one responsible for the use and application of the biometric, demographic, economical and financial assumptions.

- 55** The actuarial evaluation is made based in biometrics, demographic, economical and financial assumptions, that should be adapted to the benefit plan arrangement, or its members, to the economical environment and to the legislation in force, as well as to the activities developed by the sponsor.

- 56** Those assumptions represent long-term expectations, since they are intended to prevent future commitment up to the benefit plan termination. In addition to considering the current assumptions, it's necessary to incorporate future trends in

the actuarial procedures. For instance, it should be taken into account the current interest rate, but also the probable trend reduction, that is being foreseen for the next years. In the same way, it's advisable to observe the current expectations of mortality and longevity of the group of members, as well as to consider the trends of increase of life expectation that is occurring in the world, including Brazil.

57 The board members constant concern with the assumptions includes all arrangements of plans, since, even in DC (Defined Contribution) plans, there is the members' expectation in relation to the value of future benefit, compatible to the time of accumulation and the contribution value. The following-up of the subjects above needs to be intensified in the plans that offer investment options to their members that can choose among different combinations in the asset allocation.

58 It's important that the sponsors also know the meaning of several assumptions adopted in the actuarial evaluation, understand its operation and know how to identify its impact on the benefit plan, if the assumptions forecasts are not confirmed. Its indispensable care is constant with the adaptation of hypotheses, as a way of assuring the correct dimensioning of contributions and the real value of reserves.

59 The following –up of assumptions adherence can be made in several ways. In the cases in which the mass has enough amounts of members, statistical or adherence tests should be arranged periodically. If the number of members is insufficient, the tests can be applied uniting the mass to the one of other plans with the same arrangements. Not being feasible the accomplishment of tests, the assumptions adopted by other benefit plans in which those tests are possible, they can be taken as a parameter.

60 The board members should analyze the actuarial evaluation results, discussing them, preferentially personally, with the actuary in charge, with special attention to the divergences verified among the assumptions adopted in the actuarial evaluation and the effectively occurred with the group members. The occurrence of deviations is inherent to the use of statistical assumptions. These deviations, however, happen randomicaly: some times for more, other times for less. The observation of discrepancies for one of the senses, along the years, indicates low adherence of actuarial hypothesis.

61 The costing plan should identify the sources from where the resources necessary to the covering of the plan costs of the plan will be raised should be object of ju-

dicious analysis by board members. Its definition should contemplate the flow of the members' and sponsors' contribution, as well as the eventual use of internal resources to the benefit plan, such as the ones existing in pensions and leftovers or coming from the special reserve destination.

62 The costing plan should identify the sources from where the resources necessary to the covering of the plan costs of the plan will be raised should be object of judicious analysis by board members. Its definition should contemplate the flow of the members' and sponsors' contribution, as well as the eventual use of internal resources to the benefit plan, such as the ones existing in pensions and leftovers or coming from the special reserve destination.

The costing plan should follow the result of actuarial evaluation, defining the value or normal or extraordinary contributions required for the current year and necessary to the constitution of reserves guaranteeing the benefits, funds, provisions and to the coverage of other expenses of the benefit plan.

63 The costing plan should observe the existing provisions in regulation or adhesion agreement as for the partition of costing among members and sponsors. The board members should care for so that the rules of that department are clearly defined and legalized, in a way to minimize the risk of conflicts.

64 It's crucial that the board members have knowledge of the available financing methods in order to be able to choose the most appropriate to one to the benefit plan situation. The deliberation on the financing method should consider: if the method presupposes a stable or growing costing along future years; and if the costing generated by the method is adherent to the existing provisions in the regulation, in the sponsor's adhesion agreement or in other provisions by chance established.

65 It's worth to remind that the replacement of the financing method modifies the benefit plan actuarial result. Thus, preliminary to the decision by the method replacement it's necessary to foresee the equating form of eventual inadequacies or destination of surpluses from modification.

66 Some financing methods allow, when the sponsor adhere to, the assumption of

passed service that, if it takes place, should be duly documented and object of the board members special attention, in order to prevent the risk of future disputes, including in the legal environment. The form of financing of passed service should foresee, preferentially, stable or decreasing contributions as the time goes by and be adapted to the payment flow of benefits. Those considerations are also applied to the equating of insufficiencies observed in the operation of benefit plan.

67 The management of plans with surpluses imposed the same set of challenges to board members. It's necessary to follow-up the actuarial evaluations and the needs of the benefit plan so as to promote, within the right time, the adjustments and updating of necessary assumptions for maintenance of the economical and financial balance.

68 The extremely relevant aspect in the actuarial evaluation refers to the record of members data. It's up to the governance bodies to assure that the reliability and updating of information are permanently kept, so that the register contains the information necessary to the execution of the actuarial calculations and to the accomplishment of statistical tests of following-up of actuarial assumptions. The actions focused on the maintenance of register should foresee, for instance, the possibility of late registration of beneficiaries without having had costing forecast, or the existence of time of service to the official social security system not informed by the member, that can lead to his/her retirement on a date previous to the one foreseen in the actuarial evaluations. Therefore, the board member and pension members should be aware that the management of risks inherent to the registration issued of to paramount importance.

69 It's also important, that the actuary responsible for the elaboration of actuarial calculations, and any third party whose functions are connected to the benefit calculation, have a perfect understanding of the benefit plan and of its operation.

70 The tools of management of assets and liabilities are useful in the management of benefit plans. The development and the adoption of ancillary systems and tools to the management need to consider the relation cost x benefit. The board members should understand the adopted models, as well as the form the parameters used by them d impact the generated results, allowing, this way the accomplishment of a critical analysis of the submitted recommendations.

RISK MANAGEMENT

- 71** The creation of Previc reinforced the legal and administrative conditions necessary to the consolidation of the occupational system. It's also pointed out the knowledge accumulated by the system in the last years; it can be considered, defining standards of behavior that guide the performance of the board members.
- 72** Previc, that is the successor body of the Secretariat for Pension Funds - SPC, promotes, since 2004, improvements in the legislation to adapt the rules applicable to the occupational system to the most advanced techniques of supervision. Since then, the supervisory body has been incorporating, in the exercise of its assignments, the risk based supervision approach.
- 73** The management policy in the pension funds should include aspects such as: the governance structure; the implementation and the documentation of the internal processes; the board managers' qualification and training; the adoption of risk control systems; and the evaluation of the reached results.
- 74** It's important that the board members maintain the entity's administrative expenses under constant monitoring, since its level may impact the benefit values, mainly in plans of defined contribution (DC) and of variable contribution (VC).
- 75** The risk integrated management is important for the safety and solidity of operations accomplished by the pension funds. The entity should maintain an appropriate risk management structure that may include, if viable, the creation of a specific area that reports directly to superior instances (Advisory Board or maximum official).
- 76** It's important that the material risks and the conflicts of interest are identified, managed and solved as soon as possible, in the sense of preserving the interests of members, consolidating, this way, an important cultural change in the form of entity management.
- 77** The members of the governance bodies should gather the knowledge necessary to risk management that may compromise the accomplishment of the entity's objectives and they should be continually identified, assessed, controlled and mo-

nitored. The risks should be identified by type of exhibition and assessed as for their impact on the objectives and set goals. It's advisable; therefore, that the EFPC develops its own risk matrix for work processes.

- 78** The pension members should understand the risks related to their benefit plans and to their decisions, since these decisions influence the value of their future benefits. It's pointed out, however, that the risks have different impact in each type of benefit plan.
- 79** The financial education programs and the due communication to members, sponsors are important for risk mitigation.
- 80** Following, some risks seen as the most relevant by the supervisory body, and that will be deepened in this Guide's next issues.
- 81** The governance risk goes through the entity's areas. The suitable structure observes the entity's own characteristics - size, number of plans, plan arrangement, number of active members and retirees -, also complying with the minimum structure provided in law and in the supervisory body's guidelines. The structure should try to mitigate the risks related to the concentration of powers, assuring the segregation of functions and privileging the joint decisions.
- 82** The actual risk management intends to assure the standards of economical-financial safety, with specific purpose of preserving liquidity, solvency and balance of benefit plans managed by EFPC.
- 83** The identification of actuarial risk includes the verification of the following items: unmatching between assets and liabilities; independence of actuary's work; adherence of financial and demographic assumptions; adaptation of costing plan; compatibility of the adopted financing method; and the plan's result (surplus, balance or deficit)..
- 84** The actuarial risks are present in the defined benefit plans (DB) and of variable contribution (VC) that offers the option of life income. The monitoring of this risk, that aims maintaining the appropriate financing level, includes the constant adherence verification of actuarial assumptions, where the mortality board and the discount rate of actuarial liabilities are pointed out.

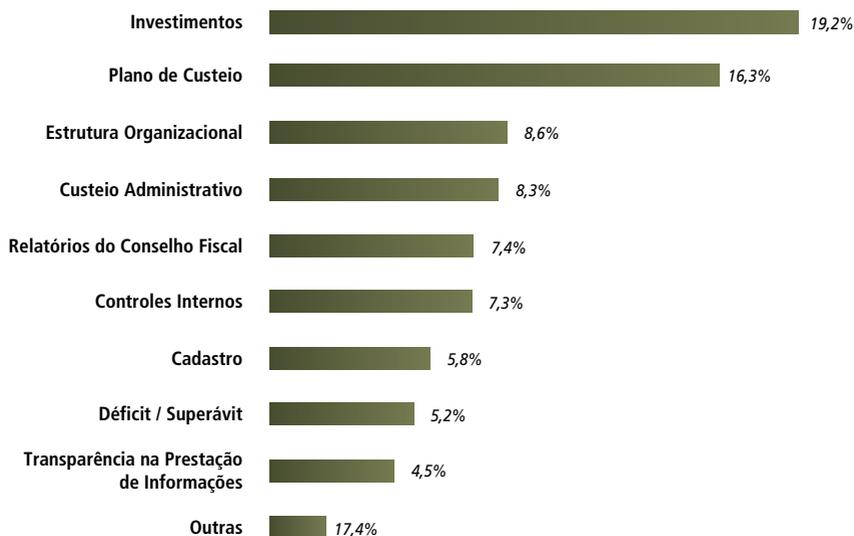
- 85** The legislation in force establishes, for effects reserve calculation purposes, a minimum table and maximum discount rate. However, the board members should always search for the most appropriate parameters to the group of members of each benefit plan. It's observed that there are already plans that adopt more conservative premises, even if this is from the increase of the plan cost.
- 86** The risk of counterpart can be mitigated by the previous analysis of payment capacity by the issuer of obligations arisen from the financial assets, avoiding, this way that potential losses impact the benefit plan negatively. The referred risk monitoring should be made in a continuous way until the obligations due date. Additionally, it's advisable to avoid the concentration of assets in a few issuers.
- 87** In the sponsor's specific case, it should be registered that the counterpart's risk includes, besides investments in fixed bonds and shares with it issuance, the possibility of not receiving the contributions foreseen for the costing the plan and amortizations regarding the contracted debts. The risk increases substantially with the sponsor's insolvency that impact, in a differentiated way, the benefit plan according to its modality.
- 88** The market risk is characterized by adverse movements of interest rate and of assets price variation that may affect the economical-financial performance of the benefit plan. The development of economical studies and the creation of sceneries are important in the monitoring of that risk, whose results should also be considered in the elaboration of investment policies of benefit plans.
- 89** The liquidity risk is related to the matching of flows of assets and liabilities, so that the resources are available on the benefit payment date and other plan's obligations. As the obligations maturity gets closer, the allocation of resources should privilege more net assets. Additionally, the planning guarantees that the disposal of assets take place within the time limit and the within the fair price
- 90** The operational risk can be reduced with the legalization of procedures and with the effective performance of the compliance areas of risk rules and management. The operation of the systems and the processing of operations may generate errors or allow the occurrence of frauds, many times, may times maintained due to faults existing in auditing and in internal controls.

- 91** The risk of information technology (IT) is put into risk operational discussion. The IT risk management should be concerned with the safety, availability, performance and compliance with the systems.
- 92** At this point, it should be reaffirmed that the statutory bodies should permanently care for the accuracy and for the consistence of the record information, determining contingency procedures and the segregation of functions among users and administrators of systems, in a way to guarantee the integrity and safety of stored data.
- 93** The legal risk appears when procedures and routines disregard legal procedures. The monitoring of legal risk is made with the creation of analysis and control mechanisms and procedures of agreements, contracts or any other documents to which the own EFPC is juridical obliged and eventually, its counterpart..
- 94** The legal risk management also includes the correct valuation and the suitable legal contingencies. It's up to the board members to act pro-actively aiming at solving timely the existing conflicts - among by-laws, regulations and the legislation in force – and reducing the contingencies provision value.

PREVIC'S RECOMMENDATIONS AND DETERMINATIONS

- 95** It's an important input to the Guide's of Best Practices elaboration the result of inspection work carried out in the last four years by the predecessor of Previc, the SPC. The analysis and the compilation of inspection reports produced at that period, allowed selecting and organizing the guidelines, recommendations and determinations given by the fiscal teams on several issues.
- 96** Within this context, it should be pointed out the inspections that were focused on the implantation inspection, by entities, of internal controls that aim adapting the management of benefit plans to the determinations of Resolution CGPC no. 13, of 2004
- 97** The diagram as follows points out the main points approached by the supervision body within the period 2007 -2010.

Gráfico 1 – Recomendações, determinações ou autos de infração da fiscalização da PREVIC, por escopo de trabalho, no período 2007-2010.



Nota: O ano de 2010 inclui apenas nove planos de benefícios com fiscalizações encerradas.

Fonte: PREVIC / DIFIS

98 From the reports whose inspections were focused on investments of benefit plans, the main guidelines are extracted that aim at the implementation or the improvement of internal controls of:

- / Inspection of application compliance with resources of plans in relation to the effective legislation, to the investment policy and the regulations (for instance: allocation of resources and application limits);
- / Verification of the risk inherent to applications;
- / Monitoring and following-up of outsourced management, especially in the observance of the legislation and of the conditions set forth in the mandate; and
- / Monitoring of operations that should be communication object to the financial activities control bodies.

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The main guidelines, regarding the costing plan item, are the following:

- / Documentation and improvement approval process of costing plan by the legal competences, as well as the permanent compliance and following up the set forth costing plan;
- / Revision and adaptation of the regulations to the costing plans;
- / Compliance to contributive parity in the plans governed by the Complementary Law no. 108 of 2001
- / Implementation of real segregation between social security and assistance plans;
- / Development of studies and accomplishment of tests for verification of solvency and adherence to the actuarial assumptions of benefit plans;
- / Implementation of actions for treatment of the benefit plan results (equating of deficit or destination of surplus); and
- / Implementation of contribution receipt control systems, including the amortizations of the debts contracted with sponsors.

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100 In the item organizational and governance structure, the main guidelines are the following:

- / Adaptation of the governance structure to the legislation or to EFPC's by-laws, including regarding the representativeness of the members;
- / Elaboration and implementation of regulations and internal rules;
- / Documentation of the selection process or of the board members election, also pointing out, the cares taken to avoid the interference in appointment or in the guidance to the position of the chosen ones;
- / Documentation of accomplished meetings;
- / Implementation of controls that verify the existence of conflict of interests,
- / assuring that the performance of functions meet the good management principles; and

/ Implementation of procedures and routines that guarantee the communication quality among the statutory bodies.

101 In the record issue, the given guidance comprise the following points:

/ Implementation of actions aiming at the efficient maintenance of registers of participants and assisted ones;

/ Implementation of controls aiming at the permanent updating of registers before Previc; and

/ Development of tools allowing the following-up of the record quality by the Audit Board.

102 Regarding the technical balance, the main guidelines of inspection are on the following items:

/ Compliance to the legal provisions;

/ Improvement of the actuarial opinion quality, including, in some cases, the accomplishment of a new actuarial evaluation;

/ Constitution and appropriate use of contingency reserve, as well as the surplus destination

/ Quick development and implementation of action plan for deficit equating;

/ Elaboration of viability assessment of benefit plans; and

/ Implementation of patrimonial segregation of benefit plans

103 Finally, the guidelines focused on the transparency of information rendering are the following:

/ Implementation of internal controls for verification of regularity and accuracy

/ of the rendered information, including the control and the guard of the sending slips;

/ Improvement of information quality, assessing the appropriate language and the opportunity of standardization of reports, and pointing out the care with

its continuous updating; and

- / Implementation of actions aiming at the access of the members to information.

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