

The Practice of Risk-Based Supervision in Brazilian Pension Funds¹

A Prática da Supervisão Baseada em Risco nos fundos de pensão no Brasil

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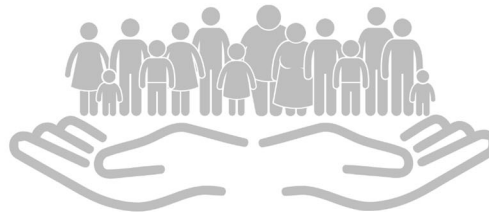
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ABSTRACT: The present paper analyzes the evolution of supervision in the Pension Funds in Brazil, focusing on the transition to the Risk-Based Supervision (RBS) model. It addresses the context of the 1998 pension reform and the introduction of the Principle of Economic-Financial and Actuarial Balance. The central objective is to present the RBS as a viable model to promote the financial-actuarial balance of pension plans managed by pension funds and protect the interests of participants and beneficiaries. The study utilizes a qualitative approach, with a bibliographic and documentary review, analyzing legislation, regulatory norms, and technical documents and considering international best practices. The research demonstrates that the RBS, advocated by the International Organization of Pension Supervisors (IOPS), has existed in the Brazilian legal framework for two decades. PREVIC Resolution 23/2023 represents a milestone in consolidating the RBS, introducing principles such as proportionality, and emphasizing preventive guidance. The practical implementation of the RBS, focusing on risk analysis and preventive action, is essential to ensure the sustainability of the Pension Fund system in Brazil, especially in the context of the system's expansion, especially after the 2019 reform, which requires supplementary pension plans to be offered to civil servants at all levels of government. The model requires constant improvement and adaptation to market dynamics, demanding investments in technology and training. PREVIC's work is a crucial factor for the success of the RBS, ensuring technical expertise and the ability to engage in dialog with the Pension Funds.

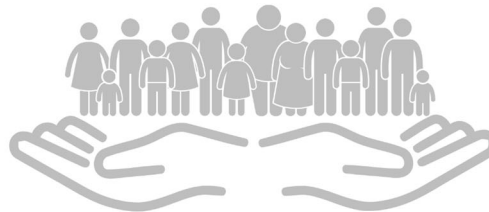
Keywords: Pension Funds System; risk-based supervision, regulation, Brazil, pension fund.

RESUMO: O presente trabalho analisa a evolução da supervisão nos Fundos de Pensão no Brasil, com foco na transição para o modelo de Supervisão Baseada em Risco (SBR). Aborda o contexto da reforma previdenciária de 1998 e a introdução do Princípio do Equilíbrio Econômico-Financeiro e Atuarial. O objetivo central é apresentar o RBS como um modelo viável para promover o equilíbrio financeiro-atuarial dos planos de pensões geridos pelos fundos de pensões e proteger os interesses dos participantes e beneficiários. O estudo utiliza uma abordagem qualitativa, com revisão bibliográfica e documental, analisando legislação, normas regulamentares e documentos técnicos e considerando as melhores práticas internacionais. A pesquisa demonstra que o RBS, preconizado pela International Organization of Pension Supervisors (IOPS), existe no arcabouço legal brasileiro há duas décadas. A Resolução PREVIC 23/2023 representa um marco na consolidação do RBS, introduzindo princípios como o da proporcionalidade e enfatizando a orientação preventiva. A implementação prática do RBS, com foco na análise de riscos e na

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atuação preventiva, é essencial para garantir a sustentabilidade do sistema de Previdência no Brasil, especialmente no contexto de expansão do sistema, sobretudo após a reforma de 2019, que exige a oferta de planos de previdência complementar aos servidores públicos de todos os níveis de governo. O modelo exige constante aprimoramento e adaptação à dinâmica do mercado, demandando investimentos em tecnologia e capacitação. A atuação da PREVIC é um fator crucial para o sucesso da SBR, garantindo expertise técnica e capacidade de diálogo com os Fundos de Pensão.

Palavras-chave: sistema de fundos de pensão; supervisão baseada em risco; regulação; Brasil; fundos de pensão.

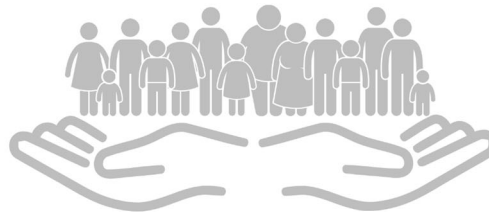
1 INTRODUCTION

We thought it was appropriate to use the article published in 2016 as a basis for this text since it would be an opportunity to evaluate what has remained established in conceptual and practical terms in risk-based supervision over the last years, the advancements made (and their speed) and the challenges that remain.

It is important to point out that, from 2016 (year that we wrote the initial article) to 2024, there was an important legal innovation. Constitutional Amendment No. 103 of November 12th, 2019 (“EC 103/2019”) was enacted, which determined that the provision of supplementary pension plans for civil servants of the Union, States, Federal District, and Municipalities is mandatory, under the terms of the new wording given to §14 of Art. 40 of the Federal Constitution. Although such a provision existed before this Amendment was enacted, it was still limited and not mandatory. As of EC 103/2019, supplementary pension plans will grow exponentially since state entities *stricto sensu* are large “employers.”

Government agencies sponsor the most significant pension funds in the world. The Federal Retirement Thrift (aimed at US federal employees), the ABP (aimed at Dutch employees), and the California Public Employees (aimed at California State employees) are consistently among the ten





most significant in the world². Therefore, we will see a significant increase in supplementary pensions in Brazil.

This factual situation raises the need for the process of state intervention in the private pension fund environment to be better prepared for the challenges that will arise. The effective practice of risk-based supervision, which was already relevant, becomes essential with this new constitutional scenario so that a growing group of workers has accumulated funds to replace income in the event of social risks, such as premature death, disability, and old age.

The Brazilian state faces an immense challenge and cannot frustrate the fair expectations of millions of public and private workers and their families.

2 CONSTITUTIONAL AMENDMENT 20/1998: A SCIENTIFIC REVOLUTION

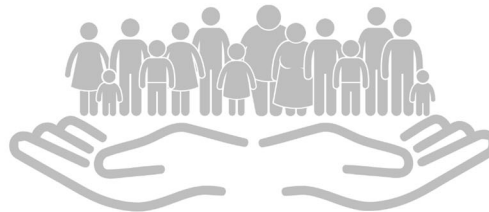
As mentioned in the 2016 article, Brazilian pension systems had a genuine scientific revolution in 1998.

Contrary to the preconceived idea that human institutions evolve linearly, history shows that advances do not unfold this way. Institutions and knowledge advance through great leaps, which often do not result from a continuous evolution of the current status quo but rather from a rupture – usually dramatic (or perceived as dramatic) – with the current situation.³

² Information obtained from WTW text at: <https://www.wtwco.com/en-au/news/2023/09/worlds-top-pension-funds-see-the-largest-assets-fall-in-20-years> (accessed on 15.07.2024)

³ The following words are from Thomas Kuhn: "If science is the collection of facts, theories, and methods collected in current texts, then scientists are men who, successfully or unsuccessfully, have endeavored to contribute one or another element to this particular constellation. Development becomes the gradual process by which these items have been added, singly or in combination, to the ever-growing stock that constitutes scientific knowledge and technique. The history of science becomes the discipline that records these successive additions and the obstacles that inhibited their accumulation. Increasingly, some suspect these are simply not the questions to be asked. Science may not develop by the accumulation of individual discoveries and inventions. (...) Normal science, the activity in which most scientists inevitably spend almost all their time, is based on the assumption that the scientific community knows what the world is like. Much of the enterprise's success derives from the community's willingness to defend this assumption—at considerable expense, if necessary. For example, normal science often suppresses fundamental novelties because these necessarily subvert basic commitments. Nevertheless, to the extent that these commitments retain an element of arbitrariness, regular research ensures that novelty will not be suppressed for long. Moreover, when this happens—that is when members of the profession can no longer evade anomalies that subvert the existing tradition of scientific practice—the extraordinary investigations begin that eventually lead the profession to a new set





It is possible to state that the reform undertaken by Constitutional Amendment No. 20 of December 15, 1998 ("EC 20/1998") was a scientific revolution, as it promoted a profound rupture with the constitutional framework in force until then regarding the Social Security System of our Country. Two new paradigms were introduced. The first of these was central for the entire system: the imposition of social security regimes with the assessment of their economic-financial and actuarial balance since this dimension was previously (oddly enough) not present in terms of essential legal guidance. The second was the introduction, in our Constitution, of the Private Supplementary Social Security Regime. In other words, private social security, which until that moment had not received regulatory treatment consistent with its economic and social importance, now does so, according to the new wording of Art. 202 of the 1988 Constitution. See the caput of the provision:

Art. 202. The private pension scheme, which is complementary and organized autonomously to the general social security scheme, will be optional. It will be based on creating reserves that guarantee the contracted benefit and are regulated by complementary Law.

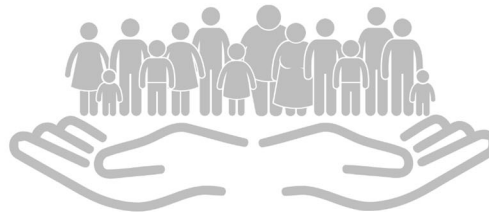
According to the transcribed Art. 202, the Private Pension Scheme – which we will also call by the Supplementary Pension Scheme or either by its most common name, the Pension Funds Scheme – presents some specific characteristics that deserve to be highlighted⁴ for this work.

Private pension plans are optional, unlike the General Social Security Regime and the Social Security Regime. Hence, the conclusion that the private pension plan has a contractual nature insofar as, here, the legal relationship is established through the offer of a plan by the sponsor (or, eventually, by the founder), formalizing an agreement of wills between the participant and the

of commitments, to a new basis for the practice of science. In this essay, the extraordinary episodes in which this alteration of professional commitments occurs are called scientific revolutions. Scientific revolutions are the disintegrating complements of the tradition to which the activity of normal science is tied" (Kuhn, The structure of scientific revolutions, 9th Ed. São Paulo: Perspectiva, 2005, p. 19 et seq.).

⁴ One of the authors of this paper had the opportunity to develop the theme in RODRIGUES, Flávio Martins. Complementary Pensions: Concepts and fundamental legal elements. Social Security Magazine No. 03, October 2005, p. 1-34.





respective entity responsible for the administration of the benefit plan. More precisely, Civil Law is contractual, as established in our Supreme Court.⁵

Furthermore, the Supplementary Pension Plan is based on the “*establishment of reserves that guarantee the contracted benefit.*” In other words, anyone who contracts a private pension plan can receive the contracted benefit. This obligation will be fulfilled using reserves that must be established when supplementary benefits are paid. It is the positivization of the so-called Principle of Economic-Financial and Actuarial Balance for supplementary pension plans.

This point will be revisited later, but it is important to emphasize that the aforementioned Principle is the central legal reference for this social security regime. All applicable rules must be interpreted in light of the exegesis that gives them the best effectiveness, allowing them to be updated in light of changing circumstances over time.

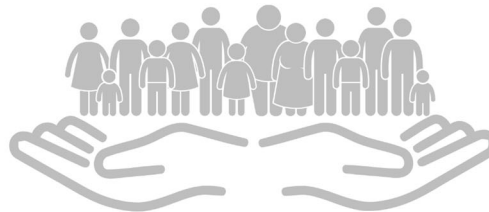
Although the central outlines were constitutionally established, the discipline of the new regime was not exhausted by art. 202 of the Federal Constitution, and the need for more detailed rules to deal with the new system was foreseen. Art. 202 indicated the need for normative integration to the complementary legislator. The infra-constitutional discipline was introduced by LC 108 (Brasil, 2001a) and LC 109 (Brasil, 2001b).

3 STATE PROTECTION IN THE RULES SUPPLEMENTING THE CONSTITUTION

The Complementary Law No. 109, of May 29th, 2001 ("LC 109/2001") regulated the pension funds scheme, incorporating, as expected, the aforementioned principles established in the Constitution. In turn, the Complementary Laws No. 108, of May 29th, 2001 ("LC 108/2001") deals with the relationship between direct and indirect Public Administration entities and their respective

⁵ See the Vote of the Rapporteur Minister Ellen Gracie Northfleet in the judgment of Extraordinary Appeal 586,453: Therefore, we understand that the Common Courts are responsible for judging this case, given the lack of an employment relationship between the beneficiary and the pension funds. Any dispute arising will be civil, not labor.





pension funds to regulate the most extensive benefit plans and new plans offered to civil servants holding effective positions under the terms of EC 103/2019.

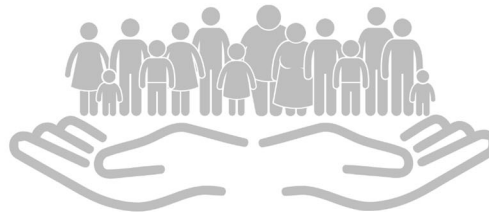
Article 1 of LC 109 (Brasil, 2001b) states that:

Art. 1 The private pension scheme, which is complementary and organized autonomously from the general social security scheme, is optional. It is based on the creation of reserves that guarantee the benefit, as provided for in Article 202 of the Federal Constitution, in compliance with the provisions of this Complementary Law.

Although a private system was established, this did not result in a total separation of the Public Administration. In addition to managing the General System, the Public Administration is responsible for ensuring the health of the private system, according to the guidelines established by Art. 3 of LC 109 (Brasil, 2001b). The Federal Public Administration is therefore responsible for, among other responsibilities: (i) formulating the general policy for supplementary pension plans; (ii) regulating, coordinating, and supervising the activities regulated by the Supplementary Law; (iii) determining minimum standards of economic and financial security, in order to guarantee the solvency and balance of the plans and entities; (iv) ensuring that participants exercise their right to information regarding the management of their respective plans; (v) supervising supplementary pension entities; and (vi) protecting the interests of the community (participants and beneficiaries). This last responsibility brings the central element to be protected and, in a certain way, brings out command capable of encompassing all the others.

The General Social Security Regime is characterized as a public service resulting from the mandatory membership feature and state management. In the case of the Supplementary Pension Regime, due to its contractual and private nature, it is characterized as an economic activity in the strict sense – to use the classic classification of Eros Roberto Grau (2015) – or, at least, an activity not exclusively committed to the state, that is, an activity that the Constitution did not determine the state to provide directly.





However, this does not mean the state has no role in the private pension scheme. Especially given the justification of the rights linked to the Supplementary Pension Scheme,⁶ State absenteeism would not be tolerated under the penalty of denaturing the Constitution.

Implementing the constituent's will, LC 109 (Brasil, 2001b) attributes highly relevant functions to the federal public authority, which is also responsible for ensuring the solvency and balance of supplementary pension entities and benefit plans.

This role of the state is neither strange nor heterodox and is enshrined in the Constitution. We have in mind Article 174 of the 1988 Constitution:

Article 174. As a normative and regulatory agent of economic activity, the state shall exercise, by the Law, the functions of inspection, incentive, and planning, the latter being decisive for the public sector and indicative for the private sector.

The Constitution assigns to the Public Administration the role of acting on economic activity through standardization, regulation, supervision, and inspection.⁷

⁶ In this sense, we have already had the opportunity to indicate the following: "In the case in question, social security, both public and private, would be covered by second-generation fundamental rights since it consists of a social right due to workers and their dependents. There is no doubt that social security support is a mandatory consequence of the primacy of work. Those who depend on their work performance to support themselves and their dependents can only have a minimum level of well-being if there is a form of support, when there are no longer personal conditions for work, whether due to age, disability, or death, to include the three main events involved. What is intended is a means of guaranteeing a dignified life for the recipients of these rights.

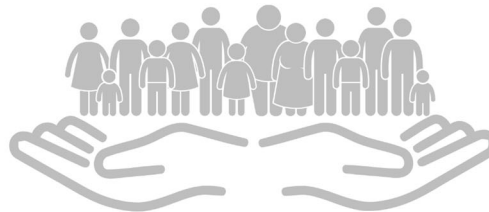
Naturally, the 1988 Constitution, sensitive to the matter, includes the fundamental rights of the second degree in its text, which are the subject of our inquiries. It is worth noting that it stated that 'the social order is based on the primacy of work, and its objective is well-being and social justice' (art. 193 – general provision of Title VIII of the Federal Constitution, which deals with the Social Order). This title includes Social Security (Chapter II), which actions in health would integrate, social security (public and private supplementary), and social assistance.

(...)

"Supplementary pension plans, analyzed in the Brazilian socioeconomic context, are strictly necessary. The insufficiency of the basic pension plan provided by the state is well-known and cannot be forgotten." see RODRIGUES, Flávio Martins. A reinterpretation of the Tax Immunity of pension funds in Light of the Theory of Fundamental Rights. Law Journal of the Association of Attorneys of the New State of Rio de Janeiro, vol. XII – Fundamental Rights. Rio de Janeiro: Lumen Juris, 2003, pp. 287-290.

⁷ Leonardo Vizeu Figueiredo says in this regard: "The transfer of public utility functions from the public sector to the private sector, expanding the latter's scope of action, with the phenomena of publicization (the so-called non-state public sector) and privatization, resulted in the state having increasing powers of regulation, inspection and planning of economic activity. The withdrawal of the state from the direct provision of such activities did not mean a reduction in interventionism but a change in parameters in the state's focus. It is because such changes made the Public Power pay more attention to the fulfillment of the inspection mission through entities without subordination, with autonomy





Therefore, the series of activities assigned to the public authority by LC 109 (Brasil, 2001b) regarding supplementary pension entities does not differ from the constitutional provision regarding the state's actions regarding economic activity.

The state must regulate, that is, issue rules that aim to establish the legal framework for the various phenomena related to the Supplementary Pension Scheme by the general objectives of public interest (or collective interest). It must also regulate, supervise, and monitor the functioning of the supplementary scheme, acting to implement the provisions of Art. 3 of LC 109 (Brasil, 2001b).

It should be noted that regulation should not be confused with traditional administrative rulemaking. Precisely, it is not even the case of a genus-species relationship. Regulation should not be understood as being a type of rulemaking.

Rulemaking, especially administrative rulemaking, is a competence inherent to the performance of the duties of the Head of the Executive Branch, as the Constitution grants him this power to promote the faithful execution of the laws.⁸

in the face of political interference, with delimited technical functions, so that the provision of essential services to the population was not subject only to the decision of private companies, but was carried out following the compliance with rules previously defined by the Public Power. This function is currently carried out by the various regulatory bodies of economic markets and sectors of relevant collective interest, as well as by the antitrust authorities that make up the Brazilian Competition Defense System, namely, the Secretariat for Economic Monitoring – SEAE, the Secretariat for Economic Defense – SDE and the Administrative Council for Economic Defense – CADE". (FIGUEIREDO, Leonardo Vizeu. The evolution of the economic order in Brazilian constitutional Law and the role of regulatory agencies, *Revista Virtual da AGU*. Year VII n 66 ([s.d.]): 1–23).

⁸ “Art. 84. The President of the Republic has exclusive jurisdiction to:

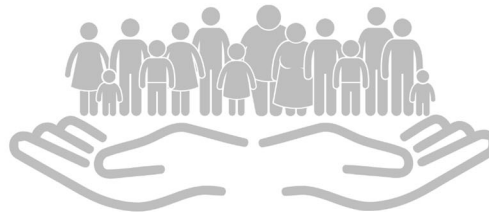
[...]

IV - sanction, enact and publish laws, as well as issue decrees and regulations for their faithful execution;" In this regard, Justice Eros Roberto Grau stated the following during the judgment of ADI 3,394 (on 04/02/2007): "In a doctrinal text, I noted the following: '[t]he implementing regulations arise from the explicit attribution of the exercise of a normative function to the Executive (Constitution, art. 84, IV). The Executive is authorized to issue them about all laws (regardless of the insertion of a provision that authorizes their issuance). Their content will be the development of the Law, with the deduction of the commands virtually contained therein. The understanding that prevails in our doctrinal regarding regulations generally applies to them without reservations. It should be noted, however, that the limitations that arise from this apply exclusively to the implementing regulations, not the 'delegated' and autonomous ones. It should also be noted that, sometimes, rebarbatively (art. 84, IV), certain laws grant the Executive authorization to issue regulations with a view to their faithful execution; this authorization will only not be rebarbative if, more than authorization, it imposes on the Executive the duty to regulate".

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Thus, rulemaking (e.g. issuance of secondary legislation) and regulation do not mix. The first is a development, an explanation of the commands provided for in formal Law. The second, in turn, is a mechanism for the State to act in the optimal compatibility of market forces with the public interest.⁹ It is no longer a heavy, highly interventionist regulation in which the Public Administration dictates models of conduct and action parameters, controls tightly, and punishes offenders in case of non-compliance.

The regulation ensures that public authorities and economic agents act harmoniously and with the greatest possible freedom, developing all their potential without losing sight of the ultimate goal of promoting the public or collective interest. It is a case of intervention to overcome so-called market failures. The aim is not to immobilize economic forces but to fully develop them in line with the higher goals of development and social justice (Article 3 of the Federal Constitution).

In this regard, Marcos Juruena Villela Souto states:

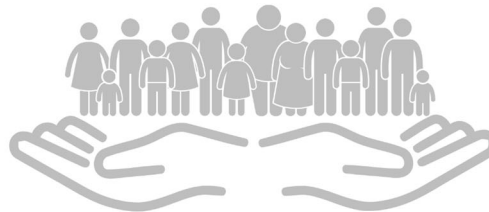
[w]ith the exhaustion of the public model of financing social needs, relations of supremacy are not always sufficient to attract private capital that complements or replaces the increasingly scarce public resources available for the various sectors of activity entrusted to the state.

Furthermore, consensus opens up more spaces for partnership and complementarity between society and its political instruments, demanding appropriate arrangements. Policies thus become more effective since they result from the agreement of wills and the freely assumed commitment—not imposed.
[...]

It is necessary to make clear that the transition from an economy based on a strong State presence, with economic monopolies and public services, does not happen overnight; the transition to the introduction of competition, where it does not exist, with a view to the free market, is gradual, under penalty of consolidating dominant positions, creating barriers to entry or permanence in the market. Here, a given sector's regulation role is defined as relevant to the economic development plan.

⁹ João Marcelo dos Santos points out that "regulation is not limited to the production of an act or a set of acts, but rather to a process, whose characteristics and dynamics depend on each legal system and each specific reality. On the other hand, in a broad sense, it means more than producing standards but intervening in exercising a particular economic activity or market. Not every standard, legal or sub-legal, can be classified as a regulation. DOS SANTOS, João Marcelo. Máximo Legal Vision of Self-Regulation. Revista de Previdência nº 2, p. 146, 2005.





Regulation will initially seek to replace the market through public choices (taking competition as a virtual parameter or comparing it with other systems in which developing segments already operate in a competitive regime). As a market is created, regulation will promote competition, prevent concentrations through the de-verticalization of activities and free access to pipelines and networks, and, in the final stage, gradually reduce regulatory intervention through deregulation (Souto, 2005, p. 2-3).

Along the same lines of consideration, Paulo Otero speaks of *"replacing the classic instruments of coercion and command (orders and prohibitions)." He states that "an informal, flexible methodology, typical of private or corporate legal action models is preferable"* (Otero, 2013, p. 288).¹⁰

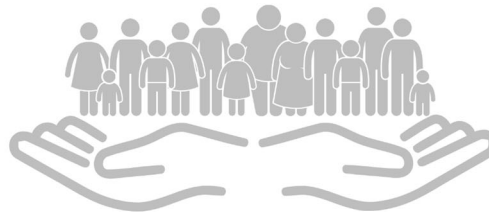
Moreover, regulation is necessary for the performance of the Public Administration. Traditional intervention, based on the prior action of the legislator and rulemaking by the Head of the Executive Branch, cannot keep up with the growing complexity and volatility of economic relations, especially when we think of non-linear evolution, as we initially mentioned. The dynamism of the most advanced sectors, which nevertheless require the action of the State, has made the traditional model unviable.

The solution found in the United States and the countries of the European Community – and transplanted to Brazil in the 1990s – was to open up legislative spaces for the action of technical, depoliticized, and independent bodies. Based on these characteristics, these new structures could work efficiently to harmonize market conflicts. Consequently, one cannot talk about regulation without simultaneously discussing delegalization and the emergence of the so-called regulatory agencies (Santos, 2009).¹¹

¹⁰ The Portuguese professor then discusses adopting *"private or corporate legal action models, transforming the contract into a privileged vehicle for exercising administrative activity, living in a 'contractual environment,' and even talking about 'contractual administration'"* (Otero, 2013, p. 288).

¹¹ Roberto Mizuki Dias dos Santos states, regarding delegalization, that: *"The performance of the regulatory function is closely related to the phenomenon of delegalization, since, in order to exercise the former, a legal situation must occur in which the legislator transfers the discipline of some issues from the scope of formal Law to the domain of sub-legal regulations. This need arose precisely because of the highly technical and complex nature of the rules that regulate sectoral activities. It became imperative to delegalize certain matters so that sub-legal regulations could discipline them with the efficiency and speed required today. In fact, it is difficult to imagine parliamentarians regulating the approval of mobile phones or the readjustment of long-distance rates"* (SANTOS, Roberto Mizuki Dias





In addition to its regulatory role, the state maintains supervisory and inspection powers within the scope of the Pension Funds Scheme to implement constitutional, legal, and regulatory commands. These tasks strongly impact the real world and assess managers' practices in each case.

In the specific case of Supplementary Pensions, there was a significant evolution in the administrative structure responsible for complying with the provisions of art. 3 of LC 109 (Brasil, 2001b). The first structure allocated regulatory powers to the Supplementary Pension Council (CPC) (later, the Supplementary Pension Management Council – CGPC) and oversight and supervision powers to the Supplementary Pension Secretariat (SPC). It was a structure based on the traditional logic of state intervention in economic activity: an intervention based on the actions of an agency directly subordinate to the Presidency of the Republic (the Ministry of Social Security). Due to this organizational model, which is based on one person's will and subject to the inevitable natural political injunctions, with less room for professionalization and performance of its functions based on strictly technical criteria, the picture drawn was that of a typical "heavy intervention" by the state. Emphasis was placed on retrospective control in light of rules that restricted the freedom of action of managers of supplementary pension entities, punishing those who deviated from a previously defined design and were insensitive to changes that had occurred in the environment. The focus was based on situations that had already occurred, facts consolidated in the real world, incapable of being reversed. The application of financial penalties or limitation of rights (suspension and disqualification) could not preserve the central element of supplementary benefit plans: the existence of reserves that guarantee the contracted benefits.

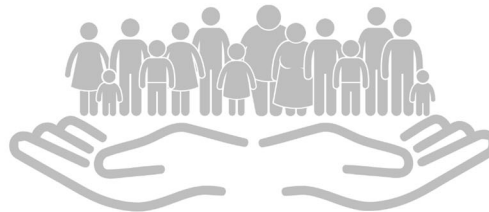
However, as mentioned previously, Social Security in Brazil underwent a scientific revolution, seeking to adapt to the best and most modern practices adopted by the most advanced countries. This revolution occurred from an institutional aspect and was concerned with the type of regulation, supervision, and inspection practiced.

dos. Deslegalização e a função reguladora da administração pública, CONSTITUIÇÃO, ECONOMIA E DESENVOLVIMENTO 1, nº 1, 2009)

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In the institutional aspect, the provision, through LC 109 (Brasil, 2001b), of a new structure for regulation, supervision, and inspection stands out. This provision is contained in Art. 5 of the Complementary Law:

Art. 5 The standardization, coordination, supervision, inspection, and control of the activities of supplementary pension entities will be carried out by a regulatory and inspection body or bodies, as provided by Law, in compliance with the provisions of item VI of Art—84 of the Federal Constitution.

LC 109 (Brasil, 2001b), therefore, provided for the existence of a supervisory and inspection body endowed with the same attributes as regulatory agencies. It was necessary to guarantee “[the] appropriate institutional structure to meet these responsibilities,” which would undoubtedly produce “the social gains of having a more expanded private pension scheme, with different forms of access and more integrated into the pension system.”¹²

Initially, the Secretariat of Supplementary Pensions (SPC)¹⁰, an agency linked to the Ministry of Social Security, maintained these inspection and supervision functions.

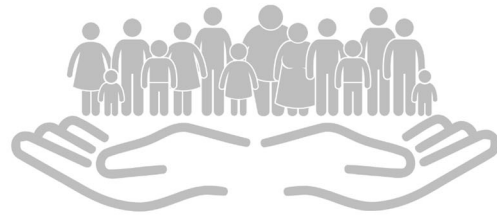
It is interesting to note the discrepancy between the institutional arrangement and the gradual but consistent development of the new legal framework inaugurated by EC 20/1998 and LC 109 (Brasil, 2001b). The latter advocated the creation of an administrative structure based on the then-recent experience of regulatory agencies in Brazilian Law to enhance the application of the new institutes and guidelines of private pension plans.

The formal institutional change was implemented only in 2009 with the enactment of Law No. 12,154 of December 23, 2009 (“Law No. 12,154/2009”), which created the National

¹² PENA, Ricardo, Pension Funds in Brazil: recent developments and perspectives. BRAZIL. Ministry of Social Security and Challenges, <http://www.previc.gov.br/central-de-conteudos/publicacoes/artigos/2009/fundos-de-pensao-no-brasil-evolucao-recente-e-perspectivas.pdf>.

¹⁰ “Art. 74. Until the law referred to in Art. 5 of this Complementary Law is published, the functions of the regulatory body and the supervisory body will be exercised by the Ministry of Social Security and Social Assistance through, respectively, the Supplementary Pension Management Council (CGPC) and the Supplementary Pension Secretariat (SPC), about pension funds, and by the Ministry of Finance, through the National Council of Private Insurance (CNSP) and the Superintendence of Private Insurance (SUSEP), in relation, respectively, to the regulation and supervision of open entities”.





Superintendence of Pension Funds (PREVIC). This Law consolidated a state entity expressly defined as an *"autarchy of a special nature, endowed with administrative and financial autonomy and its assets,"* being assigned the activities of *"monitoring and supervising the activities of supplementary pension entities and implementing policies for the supplementary pension scheme operated by pension funds (...)"*. In other words, it is an agency that does not have regulatory powers, at least not defining policies for the sector. PREVIC is responsible for supervising and supervising pension funds, as well as implementing the policies defined for the Supplemental Pension Scheme. There is still a need to provide for mandates with fixed terms and guarantees for leaders, but it is necessary to conclude that much has been done so far.

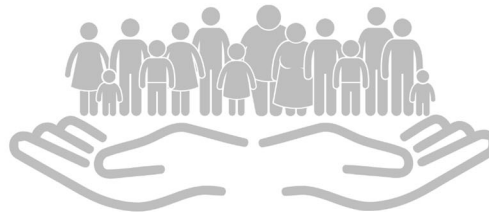
Furthermore, Law No. 12,154/2009 replaces the CGPC with the National Supplementary Pension Council (CNPC) in the following terms:

Art. 13. The Supplementary Pension Management Council, a body of the Ministry of Social Security's basic structure, is now called the National Supplementary Pension Council. It will regulate the supplementary pension regime operated by pension funds.

Thus, since 2009, supplementary pension plans have had a more modern structure in line with the best practices of state supervision. Instead of a secretariat linked to a Ministry, there is now an independent agency that, with its revenue and staff, will be able to more adequately fulfill the important task of supervising and monitoring the operation of pension funds and their benefit plans. On the other hand, there is a collegiate body whose Law requires that some of its members should part of civil society, with regulatory capacity in line with the best international practices.

The concept of standardization was also modified, which is no longer confused with mere administrative rulemaking. Here, we have a format that is more aligned with the integrative function of the contemporary state, comprising the concretization of the second vector of the scientific revolution experienced by social security. In the normative aspect, regulation, previously focused on compliance checks, gives way to a more flexible regulation capable of adapting to





changes in the environment of the Pension Regime, which ultimately implies providing the management of pension contracts with resilience capacity.¹³

4 RISK-BASED SUPERVISION FROM REGULATION

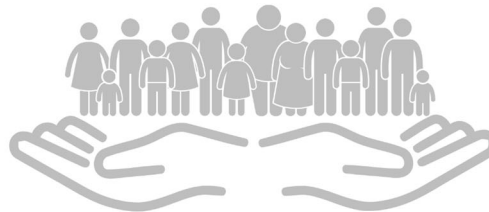
Even before Law No. 12,154/2009 was enacted, there was already a consensus that the traditional regulation and supervision model was inconsistent with the Supplementary Pension Scheme. A good example was the enactment of Resolution CGPC No. 13 of 10/01/2004 (“CGPC Resolution No. 13/2004”), which *“establishes principles, rules, and practices of governance, management, and internal controls to be observed by Pension Funds.”* This standard established relative (and not absolute) parameters for the management of Brazilian pension funds, establishing, for example, that pension entities *“must adopt principles, rules, and practices of governance, management, and internal controls appropriate to the size, complexity, and risks inherent to the benefit plans they operate, in order to ensure full compliance with their objectives.”* (Brasil, 2004).

Thus, each entity must assess its ideal operating standard, observing the most appropriate way to achieve its objectives, which, naturally, must be guided by the Principle of Economic and Actuarial Balance. This regulatory standard, which remains an important milestone even after 20 years of its enactment, could not break with the absolute view of pension entities' conduct and their managers' conduct. Non-relative standards are still required, and the same behavior is required from all Pension Funds.

Before the approval of the Law that instituted PREVIC, and in a very courageous way, reference was already being made to the risk-based supervision model, referred explicitly for the first time by CGPC Recommendation No. 2, of 04/27/2009 (“CGPC Recommendation 2/2009”). This “standard” *“provides for the adoption of Risk-Based Supervision (SBR) within the scope of*

¹³ The relationship between regulation and contractual resilience, especially in long-term contracts, was explored in ARAÚJO, Thiago Cardoso and SAMPAIO, Patrícia Regina Pinheiro Predictability or resilience? Notes on risk sharing in administrative contracts. Law Journal of the Attorney General's Office of the State of Rio de Janeiro, v. 1, p. 311-333, 2014.





the Secretariat of Supplementary Pensions about the supervision of pension funds and the benefit plans administered by them.”

The aim was to adopt a regulation and supervision model supported by this legal basis in search of effectiveness in meeting the objectives of the Pension Funds.

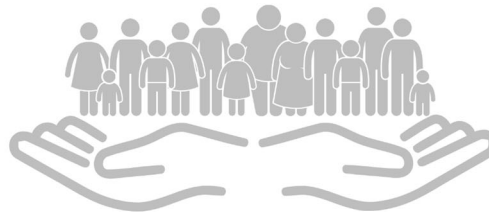
This new methodological orientation for the supervision and inspection body aims to promote a change in the agents' mindset. Compliance supervision focuses on past conduct based on assessing compliance with standards and rules, characteristics more closely linked to compliance. Risk-based supervision focuses efforts on detecting vulnerabilities that, on the one hand, may jeopardize the economic-financial and actuarial balance of the entity and, above all, of the benefit plan.

It is necessary to revisit the consequences of constitutionalizing the Economic-Financial and Actuarial Balance Principle. With Constitutional Amendment 20/1998, the focus of the sectoral legal system is shifted from the short-term flow of social security obligations, which is aimed at the immediate need for resources. The emphasis is removed from the purely financial aspect, as seen in Art. 158, § 1º of the 1967 Constitution, which spoke only of a “source of total funding” for social security schemes.

In the case of the pension funds, the sector's regulatory, supervisory, and inspection bodies, the CNPC and PREVIC, sought to establish a new methodology of action based on Risk-Based Supervision, which brings with it, inherently, the mutability in the actions of these bodies, as a condition of adaptability to the situation, preserving the contracted benefits¹⁴.

¹⁴ In the banking sector, new management practices were introduced by the so-called "Basel Accords": "The New Basel Accord (2004), better known as Basel II, is the result of the long trajectory of building a banking regulation system and, in particular, represents the unfolding of the Basel Accord I (1988). In general, we can say that Basel II represents a major evolution in adapting banks' minimum capital requirements to the risks incurred by the institutions by providing greater precision in calculating these risks. In particular, the agreement gave banks the freedom to generate their risk calculation models, adapting them to the particularities of their operations, following only a few basic principles of prudential calculation of the risks assumed. By recognizing the growing complexity of banking operations and giving freedom to generate their models, the Basel Committee intended to establish prudential risk management criteria that the world's leading financial institutions would effectively adopt. It is important to highlight that Basel II guides best practices with non-compulsory application. Each country must decide, through its competent





5 THE PRACTICE OF RISK-BASED SUPERVISION

5.1 International experiences: IOPS reflections

Risk-based supervision is an internationally recommended technique advocated by the “IOPS - International Organisation of Pension Supervisors.” In its “IOPS Principles of Private Pension Supervision,” the aforementioned organization states about risk-based supervision: “Supervisory authorities should adopt a risk-based approach and have adequate risk assessment mechanisms to use their resources efficiently.”¹⁵

In another paper from the aforementioned organization, Fiona Stewart explains what risk-based supervision is:

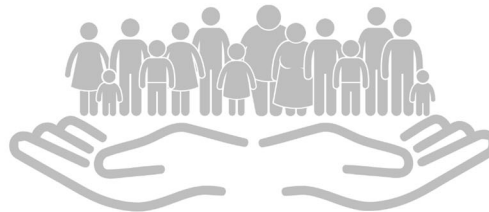
After looking at countries and their experiences in more detail, it is worth briefly explaining what 'risk-based supervision' means for pension funds. Supervision of pension schemes involves monitoring pension funds' activities to ensure that they remain within the requirements of the pension regulatory framework and protect members and beneficiaries. Supervisory activities vary significantly depending on the regulatory and legal environment, policy choices, and other factors.

Risk-based supervision attempts to adjust the scope and intensity of supervision according to the level of risk that individual pension funds, according to assessments, generate (concerning each of the pension fund's members and beneficiaries, as well as the pension fund itself). It is considered a more "sophisticated" approach than compliance-based supervision, where all pension funds (or financial institutions generally) are treated similarly. A risk-based approach allows scarce supervisory resources to be targeted at pension funds that are perceived to be at higher risk and allow supervisors to take a more proactive approach, trying to prevent potential problems before they occur (as opposed to a "reactive" approach to compliance). A broad definition of risk-based supervision would include the entire risk management architecture, including risk-based regulation and supervisory procedures. A narrower definition considers only supervision within the overall risk management architecture. The IOPS's "Principles of Private Pension Supervision" supports such a risk-based approach to pension fund supervision. (Stewart, p. 5).

authorities, which points it will sanction, including in its regulatory framework, and at what speed this will be done". GARCIA, Márcio Gomes Pinto and GIAMBIAGI, Fabio, Risk and regulation (Elsevier, 2010), p. 30-31.

¹⁵ IOPS Principles of Private Pension Supervision” (IOPS, November 2010), <http://www.iopsweb.org/principlesandguidelines/IOPS-principles-private-pension-supervision.pdf>.





Therefore, given the need to ensure the solvency of Pension Funds and their benefit plans, not only in the short term but in the long and very long term, risk-based supervision becomes an instrument of fundamental importance. It is because, unlike what occurs with compliance supervision, which has a passive, reactive nature and which *“focuses more noticeably on present and past events,”* (Pena; Galazzi, 2008, p. 157-173), risk-based supervision is proactive, having *“future events as its main focus, that is, those aspects of the regulated entity's activities subject to greater risks.”* (Pena; Galazzi, 2008, p. 157-173).

Risk-based supervision takes a systemic view of the market. It identifies pension funds and benefit plans that are most subject to risks and, therefore, deserve greater attention from the supervisory authority. This model also considers risks that do not concern this or that pension entity but the system as a whole, assessing how each entity deals with these risks.

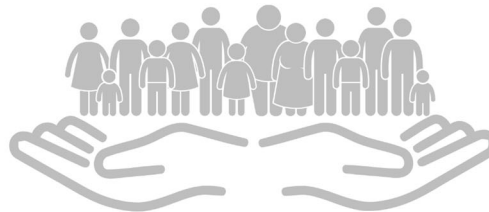
In a more recent work revisiting the topic of risk-based supervision, published in 2023, the IOPS developed the "IOPS RBS Toolkit," a comprehensive guide with detailed guidance on methodologies and lessons from supervisory authorities around the world that had already applied risk-based supervision to the pensions sector. At the time, when proposing an answer to the question "Why Adopt Risk-based Supervision?" the following conclusion was reached¹⁶:

Risk-based supervision (RBS) allows supervisors to focus their resources on the institutions and issues of most significant concern, reducing net risk to individuals and the system. It also allows institutions to obtain value-added supervisor feedback, guiding them toward more effective risk management. With the necessary legal powers, time, and resources, the implementation of RBS can be successful and welcomed by supervised entities who recognize its benefits to themselves and their operations.

There is recognition that preventive guidance and value-added feedback from supervisors are crucial to helping pension entities improve their corporate governance practices. Experienced supervisors can identify areas of weakness in pension entities' governance structures and provide specific recommendations for improvement, ensuring that these entities are better equipped to

¹⁶ The International Organization of Pension Supervisors (IOPS). The IOPS Risk-Based Supervision Toolkit. December, 2023. Available at: <<https://www.iopsweb.org/rbstoolkit/#d.en.408992>>





manage risk proactively. Furthermore, by identifying inefficient or redundant processes, supervisors can suggest changes that result in cost and time savings, allowing entities to focus their resources on more critical areas.

5.2 Internal processes of Pension Funds and the need for ex-ante assessments

While participating in the Biannual Conference of the International Pension & Employee Benefits Lawyers Association (IPEBLA), held in 2011 in Berlin, we heard an interesting report from a representative of the supervisory body for pension funds in Belgium. Following the global economic crisis that began in 2008, this body conducted a study, hypothesizing that plans with the same investment portfolios would have had similar losses. However, it was found that similar portfolios generated very different results, which led to an in-depth study. The final result indicated that pension funds with better investment processes had lower losses despite having similar portfolios. The reason given was that similar assets – the example given by the speaker was steel stocks – that had undergone a better selection process (steel companies with more consistent economic fundamentals) generated smaller losses in value in the face of the same global crisis. Some entities' internal and better-qualified prior work generated fewer losses, i.e., they maintained plans with lower probabilities of imbalances.

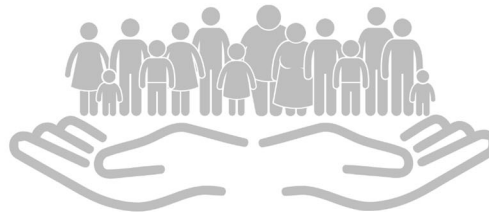
Risk-based supervision derives from the central concept that the supervisory and oversight authority should focus on preventing deviations from occurring. The above example is illustrative insofar as a qualified investment management process prevented significant losses in value in a sharp drop in asset prices on the market. Thus, there is little point (in practical terms) in monitoring actions after events that could negatively affect benefit plans and pension entities.

It does not exclusively concern the management of investor reserves. Naturally, the existence of "*reserves that guarantee the contracted benefit*" (as provided for in Art. 202, caput of the Federal Constitution) determines the achievement of pension funds' objectives. This purpose can only be achieved by controlling and paying attention to other elements: the adequate management of actuarial liabilities and the existence of qualified and sound governance.

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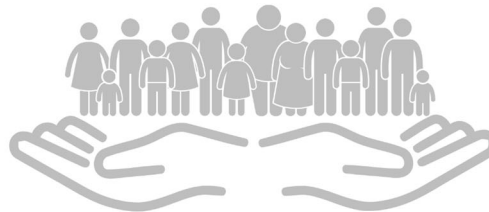
Regarding the management of the reserves guaranteeing the benefit plans, it is clear that the investment process is a fundamental element. The supervisory authority must verify whether the entities' internal processes are capable of: (i) observing the principles of security, profitability, solvency, liquidity, adequacy to the nature of their obligations and transparency; (ii) carrying out their activities with good faith, loyalty, and diligence; (iii) ensuring high ethical standards; (iv) adopting practices that ensure compliance with their fiduciary duty about the participants of the benefit plans, considering, including, the established investment policy, observing the modalities, segments, limits and other criteria and requirements established in this Resolution; and (v) diligently carrying out the selection, monitoring and evaluation of service providers related to asset management (as recommended in art. 4 of CMN Resolution No. 4,994, of March 24, 2022).

Little (if anything) will be obtained from concluding the Pension Funds investment process was inappropriate for its size and risks after the existence of losses or damages (which, by the way, are different concepts.¹⁷). Risk-based supervision should focus on the prior assessment of existing processes to verify whether they adhere to the rules of the National Monetary Council – we cite Art. 4 of the current Resolution, but many other rules need to be examined – and of the National Supplementary Pension Council, with emphasis on Resolution CGPC No. 13/2004.

Likewise, PREVIC's ex-ante attention should be given to assessing actuarial liabilities. We deal not only with defined benefit plans but also with variable contribution plans and defined

¹⁷ It is necessary to distinguish between the legal concepts of loss of value and damage due to an unlawful act. In the context of the Pension Funds, LC 109 (Brasil, 2001b) establishes that "the financial capitalization regime is mandatory for benefits paid in installments that are scheduled and continuous" (art. 18, § 1º - emphasis added). Therefore, investing is a routine (and mandatory) of supplementary pension entities, and the meaning of "provision" must be related to the reality of the investment process as a corollary of capitalization. The first concept of "financial loss" must be linked to the Portfolio Theory, whose central rule can be defined by the simplicity of the popular saying, "You should not put all your eggs in one basket." This theory presupposes diversification in investments, reducing the portfolio's overall risk through non-correlated assets. In the investment process, diversification will determine investments with positive gains and others with negative results, i.e., losses. There will only be a "financial loss" without a rational allocation of assets. In other words, for Portfolio Theory, the emphasis is not on a specific operation but on the "whole work." Reality shows that, when taking the necessary risks to achieve a high level of profitability, it is impossible always to be successful. The second hypothesis of "financial loss" relates to poor asset pricing during investment or divestment in light of the available information. It is the case of the Pension Funds that acquires a security or real estate for a price significantly higher than its market or economic value.





contribution plans with risk coverage funds. Or even defined contribution plans that outsource risks to insurers as far as possible under current regulations.¹⁸

Liability management requires a qualified and technical internal process, often involving specialized external companies. The structuring of PREVIC with its technical career (as determined by Law No. 12,154/2009) has made it possible to have qualified professionals dedicated to supervising the actuarial liabilities of supplementary benefit plans. Verifying adherence to premises, assessing the method of calculating results, processing the database, and other such tasks are fundamental to achieving the purposes indicated by the Economic-Financial and Actuarial Balance Principle. It is known that a plan may have numerous future problems due to underestimated liability calculation.

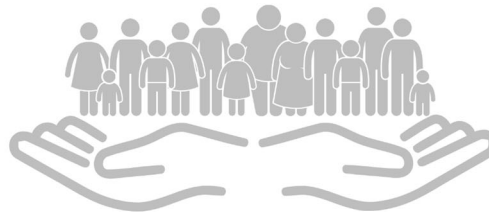
Risk-based supervision should monitor the structuring factors of actuarial calculations, prioritizing elements that may be more sensitive at certain times or plans that present more significant risks. In long-term structures, such as supplementary benefit plans, there may be a tendency to delay decisions with the possibility of determining an increase in actuarial liabilities. Risk-based supervision should be able to segregate such situations, indicating the need to review specific procedures.

Likewise, the Pension Funds' governance management determines the actions of the supervisory entity. As mentioned, these processes are relevant to achieving the objectives of better investment results and more accurate calculation of actuarial liabilities. They derive from the governance structure of the entities administering supplementary benefit plans.

LC 109 (Brasil, 2001b) determines a minimum organizational standard, composed of a Deliberative Council, a Fiscal Council, and an Executive Board, with representatives of participants and sponsors (art. 35). LC 108 (Brasil, 2001a) is more detailed on the subject but does

¹⁸ CNPC Resolution 47, of 10/01/2021, provides, in its art. 2, that “the entity may contract specific insurance, (...), in order to provide coverage for the following risks in benefit plans: I - disability of a participant; II - death of a participant or beneficiary; III - survival of the beneficiary; IV - deviations from biometric hypotheses; and V - other actuarial or financial risks. (...)”.





not differ in determining a minimum essential standard of governance (art. nine et seq.). As it is within the scope of private Law, the legal rules determine a framework in which the internal management structures are freely established through their bylaws.

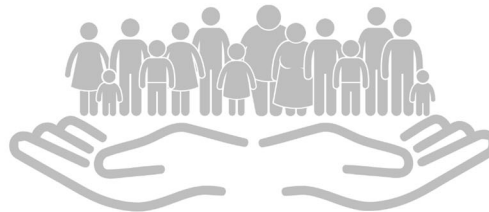
LC 109 (Brasil, 2001b), in its Art. 33, determines the *"prior and express authorization of the regulatory and supervisory body [for] the establishment and operation of the pension funds, as well as the application of its respective bylaws."* Based on risk-based supervision, this rule stands out since verifying the Pension Funds statutory rules will determine its internal governance, which must be capable of managing pension plans to achieve their objectives. Consequently, the actions of PREVIC, as an autarchy with competence for this task, must evaluate not merely formal aspects of the bylaws. It is necessary to verify whether the legal purpose of *"administration and execution of pension benefit plans"* (art. 32, caput of LC 109/2001) is based on a solid and efficient organizational structure.

It is already understood that pension plans need scale to have a low individual cost, capable of not interfering in the accumulation process. Risk-based supervision, in turn, is based on the premise that PREVIC needs to provide prior action in the event of any inappropriate conduct. The challenge is to assess the existence of solid foundations for creating a capable governance structure.

The complexity of the Pension Funds environment, whether in the management of guarantee reserves, the actuarial liabilities of each plan, or even the entity's governance, no longer supports an analog supervision model. The scale achieved today in Brazil (which should be added to the increase resulting from EC 103/2019) indicates the need for digital procedures capable of pointing out any deviations emerging to the supervisory professional. In this sense, the IOPS advises that:

Supervisory authorities broadly agree that expanding data and technology and digitalizing supervisory tasks and processes are fundamental priorities. Authorities improve their operations by continuing to invest in data, integrating it, and increasingly using advanced technologies and solutions based on data and science to support supervision. Adopting





innovative technologies (SupTech) is necessary for efficient supervision and a catalyst for developing electronic risk-based supervision (RBS) systems.¹⁹

Therefore, risk-based supervision should be operationally based on computerized systems capable of quickly receiving and classifying information from all pension plans operating in Brazil, generating analytical reports capable of supporting supervision by PREVIC.

5.3 Verification of Pension Funds professionals

Since better processes can determine better results, it must be clear that individuals carry out the processes. Given that the central concept of risk-based supervision is to anticipate risks and avoid deviations, these professionals must be previously assessed to demonstrate the technical capacity and experience capable of performing the role of Pension Funds administrators.

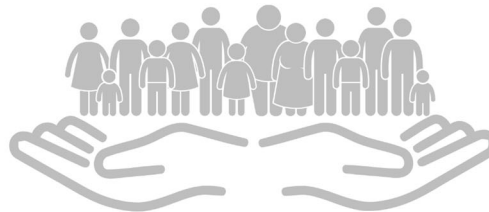
It is not the case here that the manager must be able to act with the prudence and caution of a good administrator. The concept of a good administrator conveys, in a certain sense, the idea of a passive, reactive action in a social context of stability, in which the rules have a high level of sedimentation. The fluctuations and rapid changes of the current world were not present in the ancient figure of the good administrator – the *bonus pater familias* of Roman Law. Given the current economic and social instability, we seek the figure of American Law that evolved from the prudent man to the prudent expert person (now, even without the sexist bias), which brings the technical dimension of its performance.

In short, the challenge posed by state supervisory action is its adaptation to our risky society. As Ulrich Beck notes:

[w]e are no longer concerned with the helpful use of nature or the liberation of humanity from traditional constraints but essentially with the problems arising from technical-economic development. Modernization becomes reflexive; it is becoming its subject. Questions of the development and use of technologies (in the realms of nature, society, and personality) are being eclipsed by questions of the political and economic "management" of the risks of actually or potentially used technologies – discovering,

¹⁹ Paklina, Nina, *How can digitalization make the supervision of pension plans easier and more efficient?* IOPS Working Papers on Effective Pensions Supervision, No.40 (July, 2023)





managing, recognizing, avoiding or concealing such risks about the horizons of relevance of a specific definition. The promise of security grows with risks and destruction and must be reaffirmed again and again to an attentive and critical public through cosmetic or actual interventions in technical-economic development (Beck, 1992, p.19-20).

At this point, significant progress can be made. Currently, CNPC Resolution No. 39, of March 30, 2021 ("CNPC Resolution 39/2021"), *“provides for the certification, qualification, and accreditation processes within the scope of pension funds.”*

Art. 3, §2 of CNPC Resolution 39/2021 is noteworthy, because it brought an important innovation in legal terms, although already observed in practice. The new regulatory rule included for Technically Qualified Statutory Administrators (AETQ) the need for *“specific certification for investment professionals”* (emphasis added).

There is an expansion of knowledge in the financial area, i.e., a "specialization" in investments, including a minimum of three years of experience (also provided for in Art. 3, §2 of the new regulatory rule).

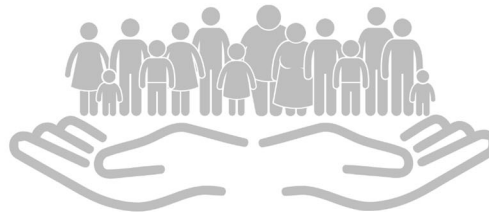
Meanwhile, art. 4, §1 of CNPC Resolution 39/2021 determined that *“prior to issuing the qualification certificate, [PREVIC] may submit to an interview the member of the executive board appointed for the role of [AETQ], considering the size and relevance of the entity, in order to confirm compliance with the required technical requirements and verify their effective technical aptitude.”*

These measures are examples of how the issue of professional verification has been implemented based on a perspective perfectly aligned with risk-based supervision.

5.4 The supervision model introduced by PREVIC Resolution 23/2023

On August 14, 2023, PREVIC published Resolution No. 23 ("PREVIC Resolution 23/2023"), considered a new milestone for pension plans, responsible for reviewing and consolidating 40 normative acts issued by the supervisory authority since 2007.





Despite its broad scope, PREVIC Resolution 23/2023 represented an advance in the practice of risk-based supervision, expressly providing for PREVIC's compliance "in its inspection procedures, with the concepts of risk-based supervision." Let us see what is provided for in Art. 228 of the regulation:

Art. 228. The National Superintendence of Supplementary Pensions shall observe, in its inspection procedures, the concepts of risk-based supervision, including in the preparation and execution of the annual inspection program, applying, where applicable, the disciplinary regime outlined in Chapter VII of Supplementary Law No. 109, of May 29, 2001.

§1º Risk-based supervision includes, among others, the identification, assessment, control, and monitoring of exposure to risks that may compromise the achievement of the objectives of the pension funds and each benefit plan administered by it, considering the size, diversity, and complexity related to them.

§2º In the preparation of the annual inspection program, the following entities will be given favorable consideration, which may imply inspection based on other provisions of Previc's inspection action:

I - have all members of the executive board, the deliberative council, and the fiscal council certified;

II - have an Ombudsman's Office to assist their participants and beneficiaries;

III - make available on their website the full minutes of the meetings of the executive board, deliberative council, and fiscal council;

IV - have established an Audit Committee;

V - have established an internal audit or compliance and risk area;

VI - have implemented an Integrity Program;

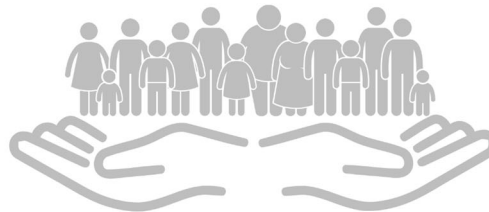
VII - do not have a recommendation or determination from PREVIC that has not been met; and

VIII - adopt adequate conflict resolution mechanisms, such as mediation and arbitration.

Based on these commands, one of the central aspects of PREVIC Resolution 23/2023 for the supervisory performance of the agency was the deepening of the adoption of the Principle of Proportionality by ensuring that the intensity and frequency of supervision are proportional to the risk profile of each entity. It allows PREVIC to focus its resources and efforts on entities that present more significant risk factors, increasing the efficiency of the supervision process and, consequently, implementing risk-based supervision. Entities that manage the most significant risks will receive greater attention in the supervision process.

The focus on the intensity of the risk led to a change in the permanent supervision model. Previously, it was directed at 18 pension funds classified as "Systemically Important Entities"





(SIE). PREVIC Resolution 23/2023 abolishes this classification and now distinguishes Pension Funds into four levels (S1, S2, S3, and S4). Permanent supervision is now directed at entities exposed to a more serious risk, which could compromise the entity's objective. Therefore, the focus is no longer on size but on risk.

PREVIC Resolution 23 also innovated when it considered positive aspects of the management of each entity in its analyses, which, in practice, requires less intervention from PREVIC. Items such as the level of certification of the executive board, the establishment of an Audit Committee, and the existence of an Ombudsman to assist participants and beneficiaries, in addition to the adoption of mechanisms for adequate conflict resolution, such as mediation and arbitration.

As recommended by the IOPS, the intensity of supervision should not be seen as an additional burden for the pension fund entity. Risk-based supervision should bring the Pension Funds and its managers a relationship of partnership and trust with the supervisory body, with indications, guidance, and feedback. The implementation of this model was fortunately consolidated in the new standard. Let us look at what is contained in Art. 229:

Art. 229. The following principles shall be observed in the supervision of pension funds:

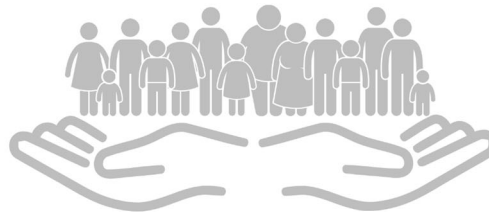
- I - focus on controlling short, medium, and long-term risks that may compromise the objectives and economic-financial and actuarial security of pension funds and the solvency and liquidity of the benefit plans administered by them;
- II - emphasis on the responsibility of board members and directors for the governance, management, and control of the entities and their benefit plans, requiring them to act prudently, ethically, and diligently, observing the presumption of good faith;
- III - development of priority actions by the supervisory body aimed at guiding the directors and directors of the entities and prompt compliance with the Law and applicable standards;
- IV - equal treatment, without prejudice to the consideration of the specificities of pension funds, such as their size, management methods, types of benefit plans, and nature of sponsors and founders, among others;
- V - preservation, and respect for the regular act of management; and
- VI - encourages the adoption of best governance practices and prudential management, as well as the establishment of internal controls and risk monitoring by pension funds.

Among the above principles, special mention should be made of the one in section III, which determines “*priority actions of the supervisory body aimed at providing guidance.*” Preventive

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guidance is essential to ensure Pension Funds directors and board members fully understand regulatory expectations and best risk management practices. By providing clear guidelines, PREVIC promotes compliance and empowers entity leaders to make more informed and prudent decisions.

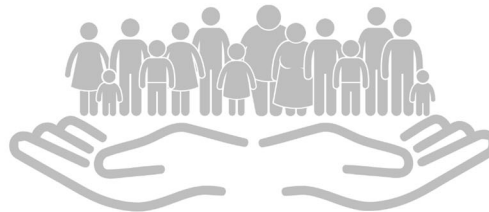
A helpful analogy for understanding the importance of preventive guidance in the context of risk-based supervision is to compare it to traffic signs on highways. Just as a traffic authority must signal the presence of a speed camera to promote less risky driving, PREVIC must proactively guide Pension Funds managers. The primary objective of the speed camera is not to punish but to prevent accidents by encouraging drivers to respect established speed limits. Likewise, by guiding expected behaviors, PREVIC is prioritizing preventive risk reduction.

Ex-ante guidance allows for the early detection of vulnerabilities that may compromise plans' economic, financial, and actuarial balance. By identifying and communicating these vulnerabilities, PREVIC guides managers to adopt corrective measures before the risks materialize and, often, without the ability to reverse them. This approach protects the interests of participants and beneficiaries and strengthens confidence in the supplementary pension system.

Over its 15 (fifteen) years of existence, PREVIC has been constantly improving its efforts to guide the directors and advisors of the entities, as well as for the prompt (and voluntary) compliance with the Law and the rules applicable to the activity of the Pension Funds. Particularly noteworthy is the publication of the Best Practice Guides²⁰, the Questions and Answers

²⁰ At the time this article was completed, PREVIC made the following guides available on its official website: Guide to Best Governance Practices (2012), Guide to Best Accounting Practices (2014), Guide to Best Investment Practices (2019), Guide to Best Actuarial Practices (2021-2022), and Guide to Best Accounting and Auditing Practices (2021).





documents²¹, the Summary of the Federal Attorney's Office with PREVIC²², in addition to the effort of normative detailing, today consolidated in PREVIC Resolution 23/2023²³.

Another relevant topic addressed by PREVIC Resolution 23/2023 was the qualification of managers, whose relevance for risk-based supervision was highlighted in the previous topic of this article, which now has specific rules depending on the Pension Funds classification level (S1, S2, S3, and S4).

Looking at the practice, the PREVIC Board of Directors announced the approval of the Annual Inspection Program (PAF) 2024²⁴, the first to follow the guidelines of PREVIC Resolution 23/2023.

According to the monitoring indications, the program foresees inspecting at least 100 entities to different degrees and depths in 2024. The system currently has 271 pension funds managing 1,146 active pension plans.

According to the agency, PAF 2024 is linked to a set of manuals to be followed, allowing for the standardization of procedures. The agency's employees will have worked on preparing 16 new manuals that will serve as a guide in the practice of supervision and inspection.

There is no doubt that PREVIC Resolution 23/2023 contributes significantly to implementing risk-based supervision by providing more precise guidelines, promoting proportionality, integrating advanced technologies, strengthening governance, investing in training, and fostering transparency. These advances allow for more efficient and effective supervision, ensuring Brazil's solidity and sustainability of supplementary pension plans.

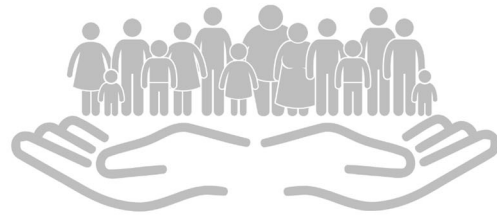
²¹ Available at: < <https://www.gov.br/previc/pt-br/publicacoes/perguntas-e-respostas>>, accessed on 12.07.2024.

²² Available at: < <https://www.gov.br/previc/pt-br/noticias/mentario-da-procuradoria-federal-junta-a-previc>>, accessed on 12.07.2024.

²³ It is worth highlighting Art. 230, §1º of PREVIC Resolution 23/2023, which, by explaining the content of the concept of regular management act, helps Pension Funds implement internal actions effectively aligned with the expectations of the supervisory body and capable of reducing risks related to decision-making.

²⁴ Available at: <<https://www.gov.br/previc/pt-br/noticias/previc-padroniza-procedimentos-de-fiscalizacao-em-2024>> accessed on 10.07.2024.





5.5 The Twin Peaks model and risk-based supervision

At this point, we cannot ignore risk-based supervision without referring to Brazil's institutional models are being object of a public discussion. There is an ongoing debate on the regulation, supervision, and oversight models applied to the capital market, financial institutions, insurance companies, and pension funds.

The Twin Peaks model establishes a form of regulation, supervision, and inspection structured in the institutions of two bodies to serve all these segments.

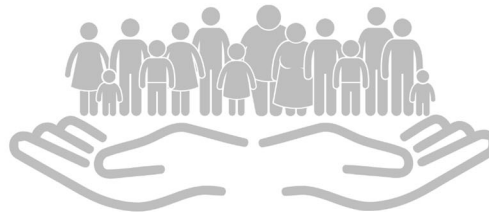
In the "first peak," a single state prudential supervision body would be established for all these environments. This body would regulate the market, supervise and monitor the institutions' soundness, and verify their security, liquidity, and other technical elements related to the legal entity in operation.

The other body, the "second peak," would supervise the conduct of such legal entities about their "clients." This body would also have regulatory tasks and focus on the behavior of institutions towards "clients" as a consumer protection body capable of assessing whether the "client" is within its risk tolerance limit (suitability).

In Brazil, the proposal to establish the Twin Peaks model would encompass the current responsibilities of the Brazilian Securities and Exchange Commission (CVM), the Central Bank of Brazil (BACEN), the National Superintendence of Private Insurance (SUSEP), and PREVIC. One body would be responsible for prudential supervision and the other for conduct supervision, both encompassing all market institutions.

The rationale behind the Twin Peaks model is that the "client" analyzes all investment environments and decides on one or more savings vehicles. According to this logic, all assets available for investment would be subject to the same standard of prudential supervision and conduct.





Although this design is still quite a minority worldwide, some important countries use it, such as the United Kingdom, the Netherlands, and Australia.

On the other hand, we have a specialized model present in Brazil and the United States. The latter country, which has the most significant and most complex capital and insurance markets, relies on the Federal Reserve (FED) for regulation, supervision, and inspection of financial institutions, the Securities and Exchange Commission (SEC) for the capital market, the Department of Labor (DoL) for pension funds and the Federal Insurance Office (FIO) for insurance companies.

The existence of different bodies focused on different realities seems necessary, generating technical specialization in differentiated markets and better protecting "clients," who are also differentiated. This model is based on the premise that the environments are different for both prudential and conduct supervision. For example, the agent who promotes banking operations is not similar to the agent who promotes the accumulation of resources for long-term use. The "clients" also have different demands. The participant in a benefit plan administered by an Pension Funds, who allocates all of his or her little available savings in this vehicle, is not similar to a prosperous investor in an exclusive multimarket fund.

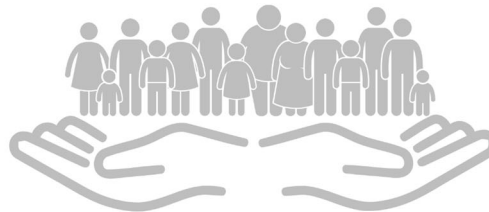
Consequently, regulation, supervision, and inspection would need to be carried out in a specific way based on experience and knowledge. The discussion is relevant and has gained public space based on Brazilian government studies and experienced professionals' opinions. This topic can profoundly change our current regulation, supervision, and inspection model of markets capable of allocating savings.

In the context of pension funds plans, the Twin Peaks model could be a step backward. As has been demonstrated, we have moved from a single-person entity (the SPC) to a specialized agency headed by a collegiate board. Members must have their expertise in this segment, which is so different from, for example, financial institutions.

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The experience of countries that adopt the Twin Peaks model reveals that the collegiate bodies of the two bodies end up composing their superior structure with a professional from each area, losing the advantage of collegiate decision-making since the tendency will be for the specialist in the area to prevail, in a one-person manner, in the decision-making process.

Risk-based supervision presupposes an innovative relational capacity between management and the administered, quite different from traditional supervision models, which start from negative situations that have already crystallized. The specialization of the various bodies facilitates dialogue.

It is also important to be clear that risk-based supervision is based on risk assessment and anticipation of solutions. Different markets have different dynamics. Banks tend to have more urgent risks, and state administration prioritizes these institutions to the detriment of long-term management processes, as is the case with the Supplementary Pension Scheme. This new institutional proposal may not bring the necessary advances aligned with the very positive practice of risk-based supervision.

6 CONCLUSION

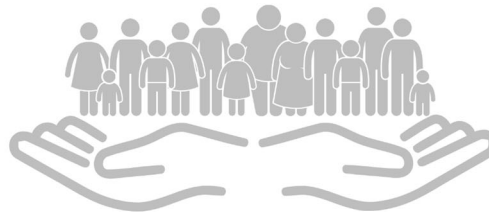
In the 2016 article, we were able to state that we must be clear that all of us – government agents, managers of entities, internal and external collaborators – participate in the fiduciary management of third-party interests and must profess to carry out what is correct and fair. As parts of a whole, which constitutes the state itself, we must have the personal commitment to materially build management capable of *"protecting the interests of participants and beneficiaries of benefit plans"* (as determined by art. 3, VI of LC 109/2001).

This assertion remains valid; however, the state's actions must advance, as must the institutions and the reality in which they are inserted. Risk-based supervision is a model that has been formally present since Recommendation CGPC 2/2009. There is a path to be followed through its implementation in practices undertaken by the supervision and inspection body,

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PREVIC. A new form of risk monitoring, capable of preventing losses, damages, and deviations from occurring, is essential. It is the practice recommended by IOPS.

It is difficult to leave old paradigms behind, but the state must fulfill its objectives. PREVIC Resolution 23/2023 consolidates a milestone capable of generating a significant advance based on the positive implementation of conduct so that risk-based supervision becomes a present reality to fulfill the state's duties. Thus, everything indicates that we are on the right track.

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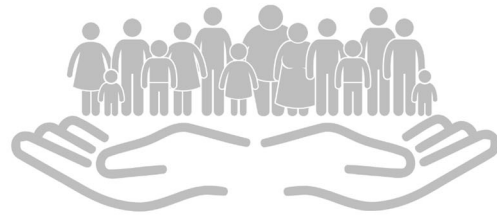
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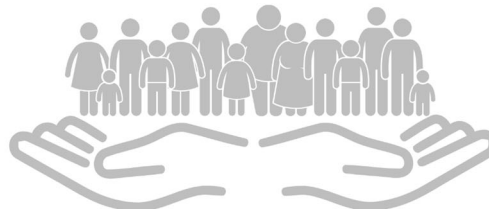
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