



**ASOCIACIÓN INTERNACIONAL DE ORGANISMOS
DE SUPERVISIÓN DE FONDOS DE PENSIONES**

PRINCIPLES OF PENSION REGULATION AND SUPERVISION¹

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I. ABSTRACT

This document outlines 31 basic principles for the achievement of pension supervision best practices in AIOS member countries. These principles set a guide for an effective supervision of affiliated workers' pension funds and of the entities involved directly or indirectly in the pension system. Even though the principles were conceptualized for the supervision of defined contribution schemes, they may readily be adapted to defined benefit systems. The observance of the principles is not mandatory for AIOS member countries but it is highly recommended to seek their inclusion in the regulation.

The principles are grouped in five categories:

A. Regulation and Supervision Foundations

1. The regulation and supervision of pension systems, regardless of the source of financing and of the coverage, is necessary due to: The mandatory nature of previsional savings, the State guarantees compromised and the importance of the preservation of public confidence.
2. The regulatory and supervisory entities should establish a regulation that facilitates a transparent, effective and efficient performance in order to protect the rights of affiliates and beneficiaries.
3. The supervisor should have adequate resources that guarantee the satisfaction of high technical standards and assure its independence.
4. The supervisor should promote the strengthening, improvement and development of the previsional culture and the pension system. Furthermore, it should seek to assure that access to the system is not discriminatory.
5. The supervisor, in the exercise of its functions, should coordinate the regulatory and control actions of other related organisms.

B. Principles Related to Pension Managers

6. The supervisor should make sure that any institution interested in becoming a pension manager, subject to the norms established on the matter, will comply with the following:
 - Managing the pension funds separately from its patrimony. This separation should be guaranteed irrevocably by means of a legal resolution or other mechanisms previously approved by the supervisor.
 - Having a well defined organizational structure in order to avoid conflicts of interest in the decision making process.
 - Contributing and maintaining an initial capital appointed exclusively for the development of its objectives, according to its importance in the pension system.

7. Pension managers should defend principles of equity, justice and no discrimination towards affiliated workers and should respect the exercise of their rights.
8. Pension managers should pay special attention to the following:
 - Risk management with an integral and preventive vision.
 - Prevention of conflicts of interest, particularly with related parties.
 - Maintenance of working capital according to financial and operative risk.
 - International standards for accounting and auditing.
 - Operating with transparency and in market conditions, particularly with related firms.
9. The regulator, seeking to minimize damage to affiliated workers and to contain systemic risk, will establish the procedures to be followed in the case of bankruptcy, liquidation or mergers of pension managers, defining the transfer mechanism for the associated funds.
10. Pension managers should establish autoregulation processes in line with the exposed principles and with the norms regulating their activity. These processes should be known to the public, to the supervisor or both.

C. *Principles Related to the Management of Individual Accounts and Benefits*

11. The supervisor should assure the existence of affiliation procedures that promote the greatest possible coverage, transparency and freedom of choice.
12. The supervisor will assure the creation of an individual account for each affiliated worker, seeking its timely and permanent update. The balance of the individual account belongs to the affiliate.
13. The supervisor or regulator should seek the efficiency of the collection system and establish adequate mechanisms for the collection of indebted contributions.
14. The supervisor should guarantee the adequate materialization of individual account transfers among pension managers.
15. Portability of individual accounts will be promoted.
16. The regulator should establish uniform requirements for obtaining benefits and should promote that affiliated workers have a periodical previsual income when the risks of disability, old age or death materialize.
17. Extensive information regarding the options available in the market and their costs should be available to workers for the election of pension modality.
18. The determination of the degree of disability should abide by clear, consistent, fair and transparent rules.

19. The supervisor should promote the transparency of the technical parameters and biometric tables used in the calculation of pensions under different modalities.

D. Principles Related to Information Dissemination

20. Affiliates should have the right to know, at all times, the information linked to their individual account.
21. The supervisor should provide periodical, comprehensive and convenient information about the provisional system and the pension managers. This information should allow the comparison between managers in terms of commissions and rates of return.
22. Publicity made by the managers should be clear and truthful, so it won't lead to fallaciousness.
23. The information supplied by the pension managers should be truthful, objective, transparent, timely and comparable.

E. Principles Related to Investments

24. The supervisor should establish the basic standards that allow the minimization of the operational risks in the investment process.
25. The supervisor should establish certification mechanisms for the pension manager's employees who are in charge of investments, in order to objectively justify their knowledge regarding investments and risks.
26. The supervisor should establish regulations that will promote the formation of efficient portfolios.
27. Transactions should take place through an authorized market with an adequate control system and with periodical availability of public information. These desirable characteristics also apply to transactions that take place through agents.
28. Investments should be made in assets emitted by entities that have an investment grade. Foreign Investment should be authorized and controlled according to diversification and risk management criteria.
29. The regulator should assure the correct valuation of all administered funds and values, through mark to market valuation conducted by a third party without conflict of interest.
30. Representative instruments of investments of pension funds should be deposited or registered in specialized custody institutions duly regulated.
31. The pension manager should adopt adequate practices of corporate governance, both in its administration policies and in the management of the affiliate's resources by means of authorized instruments. In the administration policies related to the participation of the administered funds in authorized instruments, the manager should adopt corporate governance practices.

II. PROLOGUE

AIOS is an international organism that gathers the regulators and supervisors of pension funds. It is currently formed by 12 supervising entities whose pension systems are based, totally or partially, in individual capitalization regimes. This organism was constituted as a discussion and exchange forum of experiences in pension regulation and supervision.

The Principles outlined in this document deliver the basic set of best practices in the supervision of pension systems. AIOS recommends its observance to the regulators and supervisors of all member countries as well as all non member organisms interested in improving the regulation and supervision of pension systems.

The basis of these Principles rests on four pillars essential for an adequate supervision:

- The establishment of a clear and transparent regulatory background that allows the adequate functioning of all market participants.
- The promulgation of basic norms for the adequate management of individual accounts, accumulated funds and acquired benefits.
- The disposition of publicity and information delivery standards that allow affiliates and beneficiaries to objectively compare the performance of different managers, funds and pension modalities.
- The definition of procedures for investments and conflict solutions that protect the interests of affiliates and beneficiaries.

The development of these principles responds to the need felt by some of AIOS members to abide by one of the institutional goals of the organization: *“To tend towards the greatest possible standardization of the conceptual and normative background for the regulation and supervision of the management of Pension Funds”*.

The establishment of agreements regarding minimal standards for supervision will provide the supervisory entities with a suitable instrument for the evaluation of the supervision model adopted. During the Tenth Annual Assembly of AIOS, celebrated at San Salvador on November 20 2002, the members agreed on the creation of a compendium of supervisory best practices, assigning the Supervisory Authority of Costa Rica the responsibility of coordinating efforts on this matter.

The development of these principles required several discussion forums. A first draft was circulated among AIOS members and thoroughly discussed during the *“Technical Commissions Meeting”* celebrated at Buenos Aires on April 28, 29 and 30, 2003. Furthermore, during July 10 and 11, 2003, the *“First Conference on Pension Regulation and Supervision in Latin America”* was celebrated at San Jose. This forum united all countries represented in AIOS and the OECD for the discussion of regulatory best practices. Complementarily, a wide research on the matter was undertaken.

As a result of this process, those practices reflecting the highest standards for pension fund management and supervision were compiled, creating a set of basic principles. The natural evolution of pensions market will demand a continuous improvement and updating exercise so that an effective regulation takes place, promoting the consolidation of the different regimes.

AIOS recommends the observance of the principles and the adoption of normative and institutional changes necessary for their fulfillment. Regulators and supervisors should

periodically evaluate their supervision models in order to implement improvements. These principles should be complemented with documents that will deepen the analysis of specific topics of corporate governance of pension managers and conduct codes for the officials of the supervisory body.

III. PENSION SUPERVISION PRINCIPLES

A. Regulation and Supervision Foundations

1. Objective

To establish the need to regulate and supervise the pension system, considering the authority, faculty, responsibilities and characteristics of the regulator and supervisor.

2. Principles

1. The regulation and supervision of pension systems, regardless of the source of financing and of the coverage, is necessary due to: The mandatory nature of previsional savings, the State guarantees compromised and the importance of the preservation of public confidence.
2. The regulatory and supervisory entities should establish a regulation that facilitates a transparent, effective and efficient performance in order to protect the rights of affiliates and beneficiaries.
3. The supervisor should have adequate resources that guarantee the satisfaction of high technical standards and assure its independence.
4. The supervisor should promote the strengthening, improvement and development of the previsional culture and the pension system. Furthermore, it should seek to assure that access to the system is not discriminatory.
5. The supervisor, in the exercise of its functions, should coordinate the regulatory and control actions of other related organisms.

2.1 The need of supervision

The objective of public systems of social prevision is to guarantee that individuals will receive, during their passive years, an income that will allow them to smooth consumption before and after their retirement from the labor market. Furthermore, the previsional regimes establish a protection net for those individual who, for different reasons, cannot attain an old age income, reducing the asymmetries produced by the labor markets.

Therefore, there are three types of implicit goals in the design of pension regimes: establishing a mandatory previsional savings mechanism that will allow individuals to receive an income once they have retired from the labor market, offering individuals alternatives for voluntary

savings and old age insurance, and introducing a solidarity mechanism for the satisfaction of the basic needs of a portion of the population that does not have pension resources.

The new pension models, based on individual capitalization, introduce private management of previsual savings, creating the need to redefine the State's role in the preservation of affiliates' and beneficiaries' rights.

The delegation of management should be permanently linked to the full exercise of regulation and supervision functions over the pensions market. These functions should necessarily materialize through a competent institution that seeks the maximization of the previsual funds of all regimes, regardless of the source of financing or coverage. Hence, the State should provide supervision as a public service so that its citizens will have a better future and the confidence on the system will be preserved.

2.2 *The importance of regulation*

The regulation of the pensions market is necessary to assure an adequate development of the market and the protection of affiliates' rights.

Every pension regime should have an appropriate and effective legal setting in the operations, legal, fiscal, financial and accounting areas. Its main goal should be the protection of affiliates and beneficiaries from the risk of bankruptcy of the pension manager and the risk of resource losses derived from inadequate investment or operation of managed funds.

The regulation should give the supervisor faculties for the authorization, inspection, research, law enforcement, suspension and revocation of authorization given to a private entity. Finally, it should establish an effective and efficient mechanism for resolving affiliates' and beneficiaries' claims.

It is important that the legislation consider different benefit schemes and legal requirements to access them. The supervisor should assure the existence of specific procedures which should be: clear, fair and transparent to the public. Furthermore, its application should be consistent and invariant, especially when sanction faculties are shared by two or more entities.

When supervision policy is to be changed, it is convenient for the regulator to consult interested parties. This practice will allow affected parties to be heard, promoting the establishment of a fair and technical regulation.

2.3. *Adequate resources for the supervisor*

The supervisor should be independent in its operations. The supervisor's functions should be well delimited in its mission, vision and goals. Its board of directors should be appointed in a transparent manner and for a fixed period. There should be clear and transparent procedures that will guarantee the supervisor's technical autonomy and integrity in situations when it needs to consult matters of vital importance with some other institution of greater hierarchy.

Furthermore, the supervisor should be responsible for the maintenance and management of the resources available for the development of its functions. It should have experimented personnel that will perform its duties following the strictest quality standards and the highest professional norms.

Moreover, it should seek that its personnel have an adequate training and legal protection for the exercise of its functions, that conflicts of interest be prevented and that the procedures implemented be guided by justice.

2.4. Previsional culture

The supervisor must promote competition and transparency schemes in the pension market in order to benefit affiliates and to have an adequate development of the regime. Concrete actions that contribute to this goal are those that avoid disloyal practices, entrance barriers to new pension fund managers and inadequate information.

Of special importance is the condition of workers who have to choose a pension regime or have the possibility of doing so. This implies that no person willing to be affiliated by a pension manager should be discriminated because of her age, wage, service period, working conditions, gender or marital status.

Moreover, regulators and supervisors must oversee affiliates' education and that of other participants of the pensions market, especially when working with individual contribution schemes. Beneficiaries must know their rights and how to preserve them.

2.5. Coordination among supervisors

Supervisor's capability to act in a responsible, fair and opportune way depends in some cases on the cooperation and coordination of other supervision instances. Therefore, the need to share information and experiences both at the national and international levels becomes relevant.

An integral supervising scope facilitates convergence towards common objectives. Nevertheless, the incapacity of supervisors to provide assistance can seriously commit all the efforts directed to an effective regulation. Therefore, regulation must eliminate all impediments towards cooperation between supervision organisms, must foment coordination commissions and joint operations, data bases integration and assistance agreements in other fields.

At the national level, fraud, price manipulation and operations with privileged information can affect financial markets' stability. Supervisors must work for the development of common supervising models which minimize systematic risks and regulatory arbitrage. It is recommended to suppress differentiated rules for similar operations, as well as to establish basic asset valuation guidelines and accounting rules. Nevertheless, specific rules must prevail when supervising objectives or regulated institution's aims are different.

Growing internationalization of financial activities and market globalization imply that relevant information for authorizations may be found outside national jurisdictions. Regulators must establish agreements and adequate procedures for the interchange of knowledge with their

external homologues. Portability of provisional rights will be promoted within specific arrangements that guarantee the fulfillment of the pension system's objective and free choice by affiliates.

When cooperation agreements are used to access confidential information, users must make use of it with extreme discretion in order to guarantee its confidentiality status.

B. Principles Related to Pension Managers

1. Objective

To establish objective criteria for the correct functioning of pension fund managers in order to promote an adequate development of pensions market.

2. Principles

6. The supervisor should make sure that any institution interested in becoming a pension manager, subject to the norms established on the matter, will comply with the following:
 - Managing the pension funds separately from its patrimony. This separation should be guaranteed irrevocably by means of a legal resolution or other mechanisms previously approved by the supervisor.
 - Having a well defined organizational structure in order to avoid conflicts of interest in the decision making process.
 - Contributing and maintaining an initial capital appointed exclusively for the development of its objectives, according to its importance in the pension system.
7. Pension managers should defend principles of equity, justice and no discrimination towards affiliated workers and should respect the exercise of their rights.
8. Pension managers should pay special attention to the following:
 - Risk management with an integral and preventive vision.
 - Prevention of conflicts of interest, particularly with related parties.
 - Maintenance of working capital according to financial and operative risk.
 - International standards for accounting and auditing.
 - Operating with transparency and in market conditions, particularly with related firms.
9. The regulator, seeking to minimize damage to affiliated workers and to contain systemic risk, will establish the procedures to be followed in the case of bankruptcy, liquidation or mergers of pension managers, defining the transfer mechanism for the associated funds.
10. Pension managers should establish autoregulation processes in line with the exposed principles and with the norms regulating their activity. These processes should be known to the public, to the supervisor or both.

2.1 The pension fund manager

Any institution interested in becoming a pension manager must watch out for the well being of their affiliates and the development of the pension market. They must demonstrate honesty, integrity and competence in order to carry out their functions. Furthermore, they must have financial capability and appropriate internal managing procedures.

The supervisor must undertake a complete evaluation of the authorization requests based on clear and objective requirements, previously established, that include at least one revision of the following aspects:

- A basic outline of the pension fund managers' structure which guarantees the separation of the pension fund and the managers' patrimony.
- The verification of the existence of an internal structure which allows a clear separation between the area in charge of investments, the one in charge of operations and the accounting department. Moreover, it must guarantee the independence between those who assume risks and those who register and control it.
- An initial capital requisite that assures direct participation in the business of the pension fund manager owners. This capital must be maintained and must be revised periodically by the supervisor. Minimum own resources must be directly related with the nature of the activities, the volume of the pension fund business and the risk level of the pension fund manager. The financial situation must be periodically audited by independent entities.
- Demonstration of knowledge and capabilities of the personnel, as well as their professional ethic. This process must be undertaken whenever the supervisors consider it appropriate.

The previous requirements promote trust in financial markets and must be designed to allow a pension fund manager to absorb losses, especially when huge adverse market oscillations occur. These rules must be designed in such way that supervisors have the time to intervene and achieve an orderly liquidation when necessary.

2.2 The performance of pension fund managers

Pension fund managers must have as a unique line of business the managing of pension funds and must behave always in such way to protect their clients' interests and the market's integrity. Specially, they should assure the fulfillment of their clients' rights and the avoidance of discriminatory practices.

These entities must obey integrity and diligence standards established by the supervisor. Furthermore, they must comply with the regulatory, technical, financial and countable framework that is established to operate in the market.

The pension fund manager should promote adherence of their employees and collaborators to an ethical code, as well as the design and functioning of controls that assure the compliance with behavior rules and established procedures. These elements are aimed at avoiding

conflicts of interest, especially those with the management of personal investments, those of the manager's partners and their related groups.

2.3 Pension Fund Management

Managers must not benefit themselves by going against affiliates' interests. In general, this requires internal procedures covering aspects such as: the priority of affiliates' interest, proper negotiation, punctual assignation of contributions to each individual account and an adequate commission charge. The following aspects must also be considered:

- Autoregulation and supervision processes must be promoted. The use of independent actuaries, custody services and internal independent supervision groups are among the mechanisms that may be used to implement these processes.
- Accounting and auditing principles are necessary to achieve comparable and trustworthy information. Accounting principles must assure that all the fundamental information is available and that the financial situation is properly reflected. International accounting regulation must be used when they are enough. If not, specific technically sustained rules must be dictated.
- Clear responsibilities must be established for the maintenance of the registry of the institution's operations. It is recommended that automated information systems with minimal human intervention be used in order to reduce operational risk.
- Every entity must minimize situations where conflicts of interests may be present. Moreover, potential conflicts of interests must be identified in order to assure a fair treatment to all clients by means of information disclosure, internal confidentiality rules, or the abstention to act when the conflict cannot be avoided. No entity must place its interests above the ones of its clients. Additionally, all engagements with related enterprises must be undertaken in the most transparent possible manner.

2.4 Bankruptcies, liquidations and mergers

Bankruptcy or merging of a pension fund manager may lead to losses for the affiliates and to a reduction in the confidence on the pensions market.

Regulation must diminish insolvency risk by establishing sufficient capital requirements and controls over operational risk. Regulation must contemplate measures to be undertaken when facing a bankruptcy process, in order to isolate the fact and diminish systemic risk.

The procedures of fund managers must allow investors to rescue their participations according to basis clearly established in their affiliation documents and that will allow them to protect their interests in this kind of situations.

2.5. Autoregulation processes

Well designed autoregulation processes complement supervision processes in an important way. Moreover, they allow responding with flexibility and celerity to critical situations, usually implementing ethical rules that are more severe than those established in the regulation.

Corporate governance must promote autoregulation, efficiency and security in the management of resources by means of internal and external auditing, as well as other control processes. The supervisor must verify that these processes are not exposed to the existence of conflict of interests.

C. Principles Related to the Management of Individual Accounts and Benefits

1. Objectives

- a. To guarantee the timely and correct assignation of workers' contributions and returns to the owner of the individual account.
- b. To promote schemes that allow a greater incorporation of affiliates and contributors to the system.
- c. To assure the correct and timely granting and pay of benefits to the affiliates.

2. Principles

11. The supervisor should assure the existence of affiliation procedures that promote the greatest possible coverage, transparency and freedom of choice.
12. The supervisor will assure the creation of an individual account for each affiliated worker, seeking its timely and permanent update. The balance of the individual account belongs to the affiliate.
13. The supervisor or regulator should seek the efficiency of the collection system and establish adequate mechanisms for the collection of indebted contributions.
14. The supervisor should guarantee the adequate materialization of individual account transfers among pension managers.
15. Portability of individual accounts will be promoted.
16. The regulator should establish uniform requirements for obtaining benefits and should promote that affiliated workers have a periodical previsional income when the risks of disability, old age or death materialize.
17. Extensive information regarding the options available in the market and their costs should be available to workers for the election of pension modality.

18. The determination of the degree of disability should abide by clear, consistent, fair and transparent rules.
19. The supervisor should promote the transparency of the technical parameters and biometric tables used in the calculation of pensions under different modalities.

2.1 Affiliation procedures

Affiliation procedures make it possible for workers to participate in the provisional system. These procedures must facilitate a higher coverage among the population and must contribute in the educative role that the supervisor must fulfill. Consideration of the following aspects is recommended for the fulfillment of this goal:

- The regulator must establish the necessary documentation that a person will have to submit in order to become affiliated to a pension fund manager.
- This process must take place only through qualified personnel approved by the supervisor or by means of other regulated mechanisms.
- The regulation must consider punishment processes for fraud cases or incorrect affiliation. The supervisor must have personnel qualified for the attention of all accusations and inquires on the matter.
- It is recommended to perform a validation of the provided information in order to minimize the frequency and intensity of mistakes causing delays in the accreditation of contributions. This process must be carried out by the entity in charge of collection or by the supervisor.

2.2 Individual accounts

Pension plans are implemented under financial systems of individual capitalization. The accumulation of contributions and returns will take place until the time of retirement.

The individual account allows workers and their beneficiaries to have a detailed registry of their consolidated rights. Both administrators and the supervisor must make sure that every worker has an updated and well identified account.

The ownership of the resources in the account must always be of the affiliate or, in her absence, of her beneficiaries.

2.3 Collection systems

Collection systems must guarantee broad and efficient coverage for the payment and correct identification of contributions. The supervisor must assure the existence of legal and administrative mechanisms that guarantee the collection of contributions and the application of sanctions when obligations are not fulfilled.

The supervisor must make sure the collection system meets adequate procedures that allow it to collect quotations on time, individualize contributions and distribute them correctly among the affiliates' accounts.

2.4 Account transfers

One of the main obligations of the regulator is to assure that workers may choose freely their pension fund manager when they enter the system and during their permanence.

This process generates a healthy competition between pension fund managers because it promotes lower commission levels, higher rates of return and more personalized customer service. Furthermore, it encourages managers to provide ample information so workers can compare and know their benefits.

It is not recommended that supervisors allow competition schemes where cash, credit cards, bonus or discounts over certain products or services, or any kind of gifts are offered.

2.5 Portability

Generally, workers must face a high cost when they want to change their job or retire before the established age. The portability of pension rights is essential when promoting professional mobility. This process is simplified when working with common actuarial and accounting rules.

2.6 Benefits

The main objective of a pension system is to provide economical security to those individuals who have lost their working capabilities because of old age or disability, as well to the beneficiaries of workers who have passed away. For this objective to be met there must exist protection mechanisms that guarantee acquired benefits for affiliates, especially in those regimes where contribution is mandatory.

Moreover, there should be standardized procedures for the granting of benefits. In multipillar regimes, it is recommended to make a unified payment that allows the elimination of duplicated processes.

2.7 Election of pension modality

When a worker retires from the labor market, he can choose from a variety of pension modalities, among these are programmed withdrawals, life annuities and other authorized schemes that are compatible with the previsional goal of the accumulated pension fund. In the first case, the individual account stays open in the pension fund chosen by the pensioner; while in the second option, the account remnant is transferred to an insurance company in order to acquire a life annuity.

This generates a situation where the supervision of benefits can take place in separate ways, or even in some cases, under different regulation criteria. The pension supervisor must be in

charge of the coordination of the supervision of these products in order to avoid discrimination between affiliates and the election of pension modality based on regulation asymmetries.

Additionally, the supervisor in coordination with the pension fund managers must develop information means that guarantee the delivery of broad information regarding the benefits of each retirement scheme and their respective costs. Supervising personnel and sales agents must be qualified to answer questions on the matter.

2.8 Systems for the determination of the degree of disability

It is recommended that the determination of the degree of disability be performed by a medical commission. The commission must be autonomous and must have as members individuals of recognized technical capacity and high moral standards. In order to guarantee the objectivity of the evaluation, the supervisor and the medical commission must establish clear, auditable and consistent procedures for the determination of the degree of disability.

2.9 Technical parameters and biometrical tables

The main objective of the pension system is to provide adequate replacement rates to the highest possible number of workers.

To achieve this, models for asset valuation, actuarial techniques and adequate amortization rules must exist and be established on the basis of comparable and transparent standards.

The supervisor must propitiate the existence of adequate funding processes, especially when working with mandatory regimes that serve as complement to those pensions granted by the state. The relevance of a specific pension regime must be evaluated taking into account all the sources of income a person has when she retires from the labor market.

Actuarial calculations must consider, at least, demographic assumptions, administration costs, inflation rate, population growth rate, interest rates and substitution rates among workers.

D. Principles Related to Information Dissemination

1. Objective

To propitiate that the information disseminated by different parties in the pension system be sufficient, clear, truthful and in due time.

2. Principles

20. Affiliates should have the right to know, at all times, the information linked to their individual account.
21. The supervisor should provide periodical, comprehensive and convenient information about the provisional system and the pension managers. This information should allow the comparison between managers in terms of commissions and rates of return.

22. Publicity made by the managers should be clear and truthful, so it won't lead to fallaciousness.
23. The information supplied by the pension managers should be truthful, objective, transparent, timely and comparable.

2.1 Information on individual accounts

Regulation must guarantee that sufficient and exact information be provided to affiliates, especially regarding their individual account.

It is recommended to send a periodical statement adjusted to common standards so as to facilitate its comprehension by affiliates. The statement must clearly specify all the movements in the account, the average quotation wage, the tenure of equities or fees (depending on the case) and information related to the rate of return during the period and historically. Moreover, fund pension managers must give information to their affiliates or beneficiaries whenever they demand it and must agree to answer all their questions.

Regulation must capture all these recommendations and should establish sanctions for those cases where the regulation is unfulfilled. Supervisors should make sure that statements are sent on a regular basis and that included information is precise.

2.2 Information about the previsional system

The pension market incorporates a heterogeneous population in terms of education and socioeconomic group, who must contribute to its previsional saving on a mandatory way and who generally does not have a savings culture.

The supervisor must achieve the simplification of the products offered and must work for the consolidation of the system and its credibility, distributing informative material about its operation.

Available information must allow, at least, the comparability of pension fund managers in terms of the commissions they charge, the rate of return and the risk levels they assume, and the services they deliver. All this so affiliates can evaluate their options and take all the measures they consider necessary. This information must be available for all interested parties.

2.3 Advertising

The main goal of advertising is to provide affiliates with enough information in an easy to understand format, allowing them to evaluate if the fund they are part of satisfies their needs.

Advertising done by pension fund managers must be easy to understand, punctual and must not lead to interpretation errors of any kind. Therefore, it must abide by the supervision standards established that will contemplate, at least, rate of return, commissions and service criteria.

2.4 Information supplied by pension fund managers

Affiliates' free choice regarding their pension fund manager has no meaning without the existence of comparable and timely information that allows consistent and thoughtful decisions regarding savings for retirement. In addition to the periodical information sent to affiliates, they may inquire at any time for details on their individual account.

Information delivered by pension fund managers should abide by the standards established by the supervisor, allowing comparisons and avoiding confusions in terms of interpretation.

To increase the system's transparency, it is recommended that pension fund managers publish data such as their financial statements and their portfolios' composition.

E. Principles Related to Investments

1. Objective

To establish standards for an efficient organization of investment portfolios, investment procedures and risk management.

2. Principles

24. The supervisor should establish the basic standards that allow the minimization of the operational risks in the investment process.
25. The supervisor should establish certification mechanisms for the pension manager's employees who are in charge of investments, in order to objectively justify their knowledge regarding investments and risks.
26. The supervisor should establish regulations that will promote the formation of efficient portfolios.
27. Transactions should take place through an authorized market with an adequate control system and with periodical availability of public information. These desirable characteristics also apply to transactions that take place through agents.
28. Investments should be made in assets emitted by entities that have an investment grade. Foreign Investment should be authorized and controlled according to diversification and risk management criteria.
29. The regulator should assure the correct valuation of all administered funds and values, through mark to market valuation conducted by a third party without conflict of interest.
30. Representative instruments of investments of pension funds should be deposited or registered in specialized custody institutions duly regulated.
31. The pension manager should adopt adequate practices of corporate governance, both in its administration policies and in the management of the affiliate's resources by means of authorized instruments. In the administration policies related to the

participation of the administered funds in authorized instruments, the manager should adopt corporate governance practices.

2.1 Operational Risks

Operational risks are associated with failures in the operation of a fund manager that can be translated into risks over the capital they manage. Regulation must not restrict unnecessarily the legitimate assumption of risks for the development of the business. Nevertheless, regulators must recognize the benefits for the affiliates and for the confidence in the market of designing effective mechanisms to protect the affiliates' assets from the risk of losses and insolvency of the pension fund managers.

Regulation must define minimum standards of risk management including the creation of authorized and independent investment and risk committees. These committees should have the following functions and characteristics:

Investment Committee:

- Determines the investment policy and strategy, as well as the composition of the funds' assets.
- Assigns the authorized manager of the portfolio
- At least one independent advisor should be part of the Investment Committee.

Risk Committee:

- Establishes the risk profile for the administered funds and authorizes limits, evaluation models and guides.
- At least one independent advisor (different from the one in the Investment Committee) should be part of the Risk Committee.

Additionally, the integration of a risk unit is recommended. The goal of this unit is to identify measure, monitor and inform the administration organs and officials of the quantifiable risks that pension fund managers face in their operations.

Each manager should meet minimum standards for the administration of portfolios and risks. The regulator should provide explicit regulation that minimizes risks for the affiliates. Besides, effective and legally safe dispositions to handle cases where the regulation is not met must be available.

2.2 Certification of the personnel in charge of investments

Regulation must assure that pension funds are managed by individuals qualified in investment management and risk analysis.

Therefore, it is necessary to establish a program that allows the measurement of the skills and integrity of the individuals managing the pension funds. This can be accomplished by certification processes where candidates are obliged to cover a rigorous study plan that includes a broad range of themes related to investments and risk management. Moreover, they should demonstrate skills to apply their knowledge to the decision making process and to the resolution of critical situations.

Furthermore, it is recommended that certification processes be accompanied by the adoption of the highest ethical standards that guarantee the accountability and transparency in managing pension resources.

2.3. Formation of efficient portfolios

Managers' skill and experience is related to their capacity of placing themselves on the efficient frontier given a desired risk level. This risk level must be in line with the affiliates' goals and characteristics.

Therefore, regulators should formulate investment regulation that allows the creation of efficient portfolios, taking into account the following:

- Investment horizons, which must respond to the affiliates' profile.
- Adequate diversification based on credit rating, seeking to minimize the assumed risks and to obtain an adequate return.
- The elimination of regulation that establishes bands for minimum returns, both in absolute or relative terms. In the absence of the former, the regulation should avoid asymmetries that may generate inadequate incentives that could affect affiliates.
- The elimination of minimum investment limits for instruments, entities or particular sectors.
- The authorization of foreign investment with the purpose of diversifying country risk and the concentration in a single currency.
- Allowing the use of financial derivatives in order to manage portfolios in the most flexible way possible.

Supervision must make sure that the investment policy, the institution's negotiating strategy and any other policy required by regulation have been followed, and that all the restrictions regarding the type or level of the investments have been satisfied.

2.4. Transactions

Investment procedures should be clear and punctual so they facilitate the adequate execution of transactions. Procedure manuals should include, as a minimum:

- A review of the terms and conditions of transactions.
- Mechanisms that guarantee best price execution.
- Guidelines regarding the accounting of operations.
- Clear responsibilities regarding the maintenance of investment records.
- Rules for the liquidation of operations.

Incompetence or a bad risk management can lead to mistakes in the correct execution of operations and their liquidation.

Additionally, transactions should only take place in markets that allow an adequate diversification of portfolios and that have enough participants for an adequate price formation.

Brokers through which pension fund managers operate should be adequately authorized and regulated by a financial authority. Portfolio managers should be enrolled in some duly regulated market and must have experience in trading for institutional investors. The authorization of margin accounts and leverage of titles is not recommended. Furthermore, it is recommended to work with “deliver with pay” schemes.

2.5 Investments

A mandatory pension system requires transparency and this implies investments in regulated markets and liquid instruments.

It is recommended that investments take place in instruments that have a minimum of liquidity, allowing managers to recompose portfolios if risk and return conditions require so. Moreover, assets should have an investment grade in order to minimize credit risk.

In the case of investment funds, its managers should have enough experience in managing resources and the assets of the fund should meet the highest credit quality standards.

Nevertheless, when a financial system has few available instruments, regulators should promote foreign investment as a means for extending investment opportunities and avoiding the artificial raise of prices of local assets. This requires the establishment of regulation that imposes investment limits by issuer, market and operation. Additionally, the pension manager should have the internal infrastructure that will allow the accomplishment of this kind of operations.

2.6 Asset valuation

Regulation should promote the correct valuation of total assets of pension funds and its managers, as well as the correct calculation of liquidation value.

Information regarding the value of her assets allows the affiliate to evaluate the return of her participations in a period of time. Valuation at market prices is recommended, as long as prices are available, otherwise the use of some other reliable and fair prices is recommended. There should exist clear rules to determine the price of instruments that are not very liquid. Valuation must be performed daily, by the market and carried out by a third party without conflict of interest. Supervisors should reconcile this information with the one given by financial markets.

2.7 Custody

The separation of the processes of acquisition and custody constitutes a critical element for the reduction of operational risk. Furthermore, pension funds should be administered separately from the manager’s patrimony. Therefore, there should exist a regulation that requires the custody of assets by institutions that provide such services and the facilities required by the supervisor.

Custody institutions should meet the following:

- Being authorized and supervised entities in the country where they are constituted.
- Having enough experience in providing custody and managerial services to institutional investors.
- Having enough insurance to guarantee the integrity of instruments under their custody, whether they are in physical custody, in transit or in electronic custody.

Additionally, supervisors should promote the existence of a custody contract which clearly specifies the rights and duties of both parties. It is recommended that this contract be previously approved by the supervisor.

2.8 Corporate governance

Pension managers acquire, in representation of affiliates, direct or indirect participation in the management of issuing entities. This reality generates by definition an agent problem by representing the interests of affiliates in their quality of minority participants of issuing entities. With the intention of controlling this agent problem, managers should adopt adequate corporate governance practices, as well as promoting its adoption by issuing entities that are susceptible of investment of pension funds.