

**GOVERNANCE OF BRAZILIAN PENSION FUNDS**

A THESIS

SUBMITTED TO THE

STANFORD PROGRAM IN INTERNATIONAL LEGAL STUDIES

AT THE STANFORD LAW SCHOOL,

STANFORD UNIVERSITY

IN PARTIAL FULFILLMENT OF THE REQUIREMENTS

FOR THE DEGREE OF

MASTER OF THE SCIENCE OF LAW

By

**Luciana P. Dias**

**May 2005**

## **ABSTRACT**

This thesis analyzes theoretically and empirically the governance of pension funds in Brazil. It first demonstrates that the law allows sponsors (employers) to write contracts (by-laws) governing the relationships between the sponsors, the managers and the participants (employees) of the pension funds. It also explains that, from an agency theory perspective, this legal framework favors non-optimal governance structures, since sponsors do not bear the financial consequences of the contracts they create. As predicted, the empirical evidence reported in this thesis shows that sponsors use this authority to create contracts that minimize monitoring and maximize control over business decisions to the greatest extent permitted by law. For instance, the findings show that, in writing the by-laws of pension funds, sponsors reduce the functions of management bodies in which participants have seats. Moreover, there is evidence that the by-laws contain extra requirements for the members of administrative bodies in order to ensure that the individuals elected to these bodies have a contractual or fiduciary relationship with the sponsor, and therefore, are within the sponsor's sphere of influence. The paper concludes by identifying some of the areas in which empirical assessment is necessary for the recommendation of reforms in the complementary social security system in Brazil.

## TABLE OF CONTENTS

|   |           |
|---|-----------|
| <b>INTRODUCTION.....</b>  | <b>1</b>  |
| <b>1. BRAZILIAN SOCIAL SECURITY SYSTEM .....</b>                            | <b>6</b>  |
| 1.1 The Tripartite Structure of the Brazilian Social Security System.....   | 6         |
| 1.1.1 General System .....  | 6         |
| 1.1.2 Special System for Public Employees .....                             | 7         |
| 1.1.3 Complementary System.....   | 9         |
| 1.2 Governance of Pension Funds (EFPCs) Under Brazilian Law.....            | 11        |
| 1.3 Insolvency Rules for Pension Funds.....                                 | 15        |
| 1.4 Evidence of Problems in the Governance of Brazilian Pension Funds ..... | 17        |
| <b>2. THEORETICAL FRAMEWORK.....</b>  | <b>24</b> |
| 2.1 Basic Concepts of Agency Theory .....                                   | 24        |
| 2.2 Agency Theory and Pension Funds .....                                   | 28        |
| 2.3 Limitations of Agency Theory.....                                       | 33        |
| 2.4 Hypothesis of Reaction to the Brazilian Legal Framework.....            | 35        |
| 2.4.1 Management Structure.....   | 37        |
| 2.4.2 Composition of the Management Bodies .....                            | 38        |
| 2.4.3 Requirements for the Members of the Management Bodies .....           | 39        |
| <b>3. RULES OF GOVERNANCE IN PENSION FUNDS' BY-LAWS .....</b>               | <b>41</b> |
| 3.1 Management Structure .....  | 41        |
| 3.2 Composition of the Management Bodies.....                               | 45        |
| 3.3 Requirements for the Members of the Management Bodies .....             | 52        |

|  |           |
|--|-----------|
| <b>CONCLUSION .....</b>  | <b>56</b> |
| <b>APPENDIX I .....</b>  | <b>60</b> |
| <b>I. THE EMPIRICAL RESEARCH.....</b>  | <b>60</b> |
| 1. The sample .....  | 60        |
| 2. Observations in Relation to the Sources and Coding.....                   | 62        |
| 3. Terms .....   | 63        |
| <b>II. FINDINGS - TABLES.....</b>  | <b>64</b> |
| <b>III.FINDINGS – ANALYSIS.....</b>  | <b>73</b> |
| 1. Size.....   | 73        |
| 2. Term of office .....  | 73        |
| 3. Removability.....   | 74        |
| 4. Composition.....  | 74        |
| 5. Other Observations in Relation to the Information Collected .....         | 76        |
| <b>APPENDIX II.....</b>  | <b>77</b> |
| 1. Important Figures.....  | 77        |
| 2. Funds Sponsored by Private Entities .....                                 | 78        |
| 3. Funds Sponsored by Public Entities .....                                  | 79        |
| 4. Representativeness of the Full Sample .....                               | 80        |
| 5. Representativeness of Each Sub-Sample in Relation to the Full Sample..... | 80        |
| <b>BIBLIOGRAPHY .....</b>  | <b>81</b> |