Review of Selected Developments in Latin American Law During The Year 1997

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The 1997 report of the Inter-American Law Committee highlights developments in Latin America's financial and social security sectors. The law in both sectors underwent important modifications over the past few years, and setting forth highlights of developments in 1997 should give the reader a general idea of the form and content of the changes that are taking place in these sectors.

The following developments are selected for treatment in this report: (1) Argentina: The requirement that the *prepaga* offer the Obligatory Medical Program; (2) Bolivia: Reform of the social security pension regime; (3) Brazil: The authorization of supplemental individual retirement accounts; (4) Chile: The enactment of new banking legislation; (5) Peru: Regulation of the privatized health component of the social security system; (6) Uruguay: Establishment of investment accounts; and (7) Venezuela: Promulgation of the basic law for reform of the Social Security System.

I. Argentina: Application of the Obligatory Benefit Plan to the *Prepaga*

In Argentina, health benefits are generally provided by the *Obra Social* or the *Prepaga*. The *Obra Social* is a type of employee organization that receives mandatory payroll deductions from workers electing to affiliate with it. Prior to January 1, 1997, workers were obligated to affiliate with the *Obra Social* organized to serve that sector. The *Obra Social* is a regulated entity established pursuant to a special statutory regime and regulated by a dedicated regulator. The *prepaga* is typically a regular for profit entity that in return for payments by its affiliates agrees to provide

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medical benefits either directly or through providers with whom it contracts. Historically, the *prepaga* was not a regulated entity; in 1997, that began to change.

In 1997 two important developments took place in this sector. First, workers were permitted to select the *Obra Social* with which they would be affiliated. Second, the *Obra Social* and the *prepaga* were required to provide a minimum benefit plan, which, *inter alia*, included coverage for human immune deficiency syndrome. Observers anticipated the reforms might permit the *prepaga* to compete directly with the *obra social* for the payroll deductions of the workers, but the reforms finally enacted did not permit a worker to select a *prepaga* in place of an *obra social*. The reforms did make reference to a regulator for the *prepagas*, but the framework for that regulator was not enacted.

II. Bolivia: Social Security Reform

In May 1997 a comprehensive reform of the social security pension system took effect. The reform, which was enacted in 1996, adopted a system similar to the Chilean pension reforms. The law restructures the regulation of Bolivia's financial sector by creating a Regulatory System for the Financial Sector, under the supervision of a General Superintendency, comprised of the Superintendency of Pensions, the Superintendency of Banks and Financial Entities, the Superintendency of Insurance and Reinsurance, and the Superintendency of Securities. The Superintendency of Pensions was newly created by the law, and the Superintendency of Securities replaced the National Securities Commission.

The law authorizes the Superintendency of Pensions to license companies to function as pension fund administrators. The pension fund administrator is a closely regulated entity that collects the required contributions from employers (who pay some contributions directly and collect others from their workers as withholding agent), invests those funds, and—under certain circumstances—administers the payment of mandated social security benefits. The pension fund administrator also establishes individual pension accounts for the workers affiliated with the administrator. The funds are not assets of the administrator and are free from the reach of creditors of the administrator. The mandated social security benefits include: a pension benefit, a general disability benefit, a general death benefit, workplace related disability and death benefits, a funeral expense, and periodic payment benefits. The funeral expense and periodic payment benefits are financed out of proceeds of the privatization of certain formerly state-owned enterprises. The funeral expense and periodic payment benefits are administered by certain pension fund administrators appointed as a type of trustee for the capitalization funds financing the funeral expense and periodic payment benefits.

Investment of the proceeds of the pension funds must be made subject to the guidelines established in the law. Up to fifty percent of fund assets may be invested outside the country.

Some of the risk assumed by the administrator is to be transferred to life insurance companies selected by a public bid process for provision of those services. When affiliates are entitled to receive pension payments from their accounts, the payments may be made directly by the administrator under a type of settlement option structure, or, upon the instruction on affiliate, may be made by one of the specially chartered insurance companies under an annuity contract purchased with the fund balance.

Qualified Pension Fund Administrators applicants are awarded licenses through a public bid process. The administrator must be a Bolivian stock company organized with a single corporate purpose. The purpose is defined in the law as: (1) the administration and representation of pension funds; (2) delivery of the benefits and services established in the Social Security law and regulations; (3) the contracting of the services necessary to perform the administrator's activities; (4) investment of its own resources in entities that perform services of custody of securities, computerized systems, and payroll systems; collection systems; systems for the collection of late fees; and systems for the payment of obligatory, long-term social security benefits; and (5) the offer of variable monthly annuities to affiliates and their funds comprised of contributions made by workers and employers.

III. Brazil: Individual Programmed Retirement Accounts

The Brazilian Social Security System was the subject of intense political debate during 1997. The year ended with consideration by the Brazilian Senate of a bill that overhauls the system. In addition to the state run system, Brazil also, since 1988, permits in various forms the supplementation of the statutory benefit with *previdência privada* plans.

In 1997 a law permitting the establishment of individual retirement accounts was enacted (Law No. 9477 of July 24, 1997). The law permits the establishment of funds to be constituted by employer and employee contributions. The National Monetary Board determines the types of investments that may be made with plan assets. Any person engaged in remunerative activity may purchase shares of the funds, and the employer may do so in the names of its employees and administrators when it establishes an Incentive Plan for Programmed Individual Retirement. All shares must be acquired in national currency. The funds may be established and administered by financial institutions or by insurance companies authorized to function by the Superintendency of Private Insurance.

The National Monetary Council will approve the regulations regulating the establishment of the Individual Programmed Retirement Funds. The regulations will cover, at a minimum: (1) incorporation and its characteristics; (2) administration; (3) the administrative fee; (4) the composition and diversification of the portfolio; (5) net worth; (6) the issuance, sale, and surrender of shares; (7) rules governing the contributory plans; (8) portability, after the expiration of a period of at least six months; (9) custody and liquidation investment instruments held by the funds; (10) general assembly; (11) financial demonstrations; (12) the supplying of information to the Central Bank, the Securities Commission, and the Superintendency of Private Insurance; (13) the publicity and *remessa* of documents; (14) the application of sanctions; and (15) the development of general norms. The National Monetary Council may limit the investment of plan assets in controlled, affiliated, or interrelated securities issued by the founder of the fund or its administrator.

The Central Bank and the Superintendency of Private Insurance are authorized to: (1) authorize the incorporation of Individual Programmed Retirement Accounts and the transfer of their administration; and (2) exercise review of the fund administrators and apply the appropriate penalties for infraction. The Securities Commission is also authorized to regulate the type and mix of the securities that comprise a fund.

The administrator is obligated to undertake all acts necessary to the administration of the fund and to exercise all rights pertinent to the assets of which the Fund is composed, either directly or through contractual arrangements with third parties. In the event third parties are contracted to provide services, the third parties are jointly liable for the damages they may cause the fund. All buy and sell orders of shares and securities must always be issued along with precise identification to the fund. The assets of the funds are generally free from creditors.

The employer who institutes an Incentive Plan for Individual Programmed Retirement, in the form established by the National Monetary Council, may deduct as *despesas adquiridas*, provided the plan covers at least fifty percent of the employees. Resources utilized by the employer for the acquisition of fund shares for its employees and administrators generally cannot be used to calculate labor benefits and work related employer contributions. Contributions made by the employer in the name of an employee continue to be the property of the employee, but those funds can only be moved to another fund after the expiration of the capitalization period for those contributions.

The partial or total surrender of the Individual Programmed Retirement Fund may be done: (1) free of the Tax on Credit, Exchange, and Insurance Operations relative to securities after a period of ten years, counted from the initial contribution for the formation of the patrimony and in the cases of permanent disability, retirement, or the death of the participant; (2) with the application of the Tax on Credit, Exchange, and Insurance Operations relative to securities, calculated *à alíquota* of twenty-five percent on the amount surrendered before the ten year period, calculated as the date of the initial contribution; (3) if the participant is permanently disabled, retires, or dies, the tax described in (2), above, is not assessed. After the expiration of the ten-year capitalization period, participants may withdraw part or all of their shares, *podiendo adquirir renda junto a sociedade seguradoras ou a entidades de previdência privada.*

The acquisition price of shares may be deducted by natural and juridical persons. The natural person may deduct up to R$2,400.00, and the juridical person may deduct up to ten percent of the gross salary of each employee or administrator in the case of an employer. The deduction is not available to natural or juridical persons maintaining a private provisional plan. Withdrawals are subject to income tax, which is withheld at the source in advance of the filing of the tax return. The property and rights constituting the patrimony of the Individual Programmed Retirement Fund are not part of the patrimony of the administering institution in the event of failure or liquidation of the institution. The transfer of assets from one fund to another or to purchase a qualified annuity account is not a taxable event for the purpose of the Tax on Credit, Exchange, and Insurance Operations relative to securities or the income tax. The tax deduction is not available for transfers of this type.

IV. Chile: New Banking Law

In December 1997 the President of Chile issued a decree with force of law that consolidated the existing banking legislation and introduced some important changes. The law contains titles on: (1) The Superintendency of Banks and Financial Institutions; (2) The Incorporation of Banking Enterprises; (3) General Rule Applicable to Banks and their Administration; (4) Capital, Reserves, and Dividends; (5) Operational and Solvency Ratings; (6) Deposits and Reserves; (7) The Relationship between Assets and Net Worth; (8) Banking Operations; (9) Affiliated Companies; (10) Operations Abroad; (11) Lending Limitations; (12) Fiduciary Activities; (13) Mortgage Operations Secured by Letters of Credit; (14) Financial Enterprises; (15) Measures to Stabilize or Compel Liquidation of Banks; (16) Bank Secrecy and Other Norms; and (17) Penal Sanctions.

Of particular interest to the foreign investor are the titles on the Incorporation of Banks and Operations Abroad. Title II, Incorporation of Banks, establishes the conditions under which a foreign financial institution may participate "in a significant way" in the creation or acquisition of stock in a Chilean bank or establish a branch office in Chile. Title X, Operations Abroad, sets forth the conditions under which Chilean banks may conduct operations in foreign countries. Additionally, the adoption of the Basle criteria should permit foreign banks to engage in certain financial activities without having to invest or to retain relatively high amounts of capital.

In general terms, the legislation permits banks to engage in operations and activities related to the banking function that were prohibited under the prior legislation. Also, the discretion of the superintendency in deciding whether to grant new banking licenses was restricted somewhat by the imposition of more objective legal tests and requirements in the approval procedure. The Chilean legislation should become the model for reform of banking legislation in other Latin American countries.

V. Peru: Social Security Health Regulations Issued

On September 9, 1997, regulations issued by the Peruvian Minister of Health implementing the reforms to the health component of the Social Security system legislated in 1996 were published in *El Peruano*. Prior to the enactment of the restructuring, the government through the Peruvian Social Security Institute provided health benefits directly to the affiliates of the system in return for the contribution required by law to be made by all salaried employees and their employers.

Under the new regime, a comprehensive benefit plan is mandated for participants in the social security system. Basic benefits may be provided by the Peruvian Social Security Institute, the employer directly, or a new entity known as the *Empresa Prestadora de Salud* (EPS). Catastrophic benefits remain the responsibility of the Peruvian Social Security Institute. The employer may elect between providing the basic benefits directly or using an EPS to provide the benefit. If the benefit is to be offered through the EPS, the EPS is selected by vote of the workers. Although the workers must participate in the EPS selected by election if they wish to participate in an EPS, workers may also opt out of the EPS and have the Peruvian Social Security Institute provide the benefits. The division of benefits between basic and complex is set forth in the regulation.

The reform establishes a new regulator dedicated exclusively to the regulation of the EPS. This regulator, called the Superintendency of *Entidades Prestadores de Salud* (Health Provider Entities), authorizes the operation of new EPS and supervises the ongoing operation of EPS.

The *EPS* is regulated by a new superintendency established for that purpose. The regulations permit the employer to elect among the provisions of the mandated health benefit by either (1) the social security administration; (2) directly by the employer; or (3) through an EPS. The regulation lists conditions and benefits that must be covered by the social security system. Also listed are optional benefits coverage that may be purchased by affiliates. For salaried employees, the amount of the contribution to the system is fifteen percent of the affiliate's salary.

VI. Uruguay: Investment Funds

On June 3, 1997, the Central Bank issued Circular No. 1,549, which implements the Investment Funds Act, passed by the Uruguayan Congress on September 17, 1996. Investment funds are defined as an independent group of assets delivered or paid-in by individuals or legal entities to be invested in securities or other assets. Participation in the funds must be evidenced by shares. The fund is not a separate entity; it must be administered by a managing entity that acts on behalf of the shareholders.

Administrators must be previously authorized by the Central Bank. Information supplied to the Central Bank by the administrator is protected by bank secrecy regulations. The administrator must be organized as a stock company whose stock is evidenced by registered shares. Banks are permitted to establish administrators and to purchase shares in them. The transfer of the ordinary stock of an administrator requires the prior authorization of the Central Bank.

Administrators are required to disclose any material information regarding both the fund and the administrator. Material Information is considered to be facts which a diligent person considers in making an investment decision. The administrator, its directors, and its managers are precluded from acquiring securities that are part of the fund managed by the administrator.

The administrator is also required to issue a regulation for the purpose of governing the relationship between and among the shareholders, the fund, and the administrator. The regulation must set forth, inter alia, the nominal value of the shares, the number of shares, any request that the shares be quoted in a local or foreign capital market, the investment policy of the administrator, the procedures for the issuance and redemption of shares, and the commissions and expense reimbursements the administrator may charge. The administrator is also required to issue a prospectus to be used in connection with the sale of the shares.

Funds may be comprised of: (1) securities registered with the Central Bank; (2) public, national, or foreign securities; (3) demand deposits and time deposits made with financial intermediation institutions; (4) securities issued and quoted on the official markets of third countries previously authorized by the proper authority of the foreign country; and (5) any other assets and securities authorized by the Central Bank. The Central Bank is authorized to issue regulations governing the maximum percentage of fund assets that may be invested in securities of the same issuing entity, the maximum percentage to be placed in banking deposits, and the like.

VII. Venezuela: Comprehensive Social Security System

In November 1997 the framework for a comprehensive reform of the social security systems was enacted into law. The law establishes the general principles governing the working of the Comprehensive Social Security System and anticipates that the specific components of the system (identified as subsystems) will be enacted in special laws not yet promulgated. Of great importance is the recognition of the role of the private sector in the provision of social security benefits. Although the precise parameters of that participation are not known at the present time, it appears the reforms will be influenced by Chile's reform in the area. Under the Chilean reforms, contributions for the respective benefits are paid or delivered to private administrators that set up worker accounts and assume the risks of providing the subject benefit or benefits. Among other areas, the reforms likely will include pensions, health, and workers' compensation.