

# Centralised Recordkeeping: International Experience

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Reform of pension systems around the world has thrown up a central question with regards to organisation of the new pension system i.e. that of centralised record-keeping vs. decentralised recordkeeping. In the former case the record-keeping in the system is centralised with one entity whereas in the latter the fund manager is responsible for the same. Of the reforming countries Poland, Sweden, Mexico, Argentina, Turkey, Kosovo, Dominican-Republic, Kazakhstan have opted for centralised record-keeping of their pension systems. Another example of a centralised record-keeping system is the Thrift Savings Plan (TSP) in the US. India faces several policy questions in its quest to set up the CRA ranging from the process of setting up or selecting the CRA, to the ownership of the CRA, from system design and implementation of the CRA to the regulation of the CRA.

## 1 Functions of the CRA

The CRA functions range from mere recordkeeping of the data to more complex tasks such as facilitating movement of funds, account handling for the customer, facilitating switching between pension fund managers etc. At its simplest the CRA has the sole responsibility of maintaining data about the customers account and his choice of fund managers (Belgium). At its most complex the CRA not only manages this data, but it also undertakes a process of netting of contributions before passing them on to the PFM as well as the process of unitisation and accrediting the units to the customers account and self producing annuities at the time of vesting. (Sweden).

A Defined contribution system is a choice driven system wherein an individual has the opportunity to specify the fund manager as well as the scheme where he wants to invest his contributions. However, this presupposes sound financial literacy of the populace, which is often not the case. The CRA has in several countries such as Sweden, Kosovo been responsible for educating the public on the pension system and the process of fund management.

## 2 Setting up the CRA

Setting up an entity that has the mandate to manage the record-keeping of all transactions of all customers is a sizable task and requires sound IT infrastructure. Setting up of a CRA calls for sizable investments either by the government or the private entity serving to function as the CRA. The option for countries is to set up a new entity to handle the operations or to pass on the mandate to existing service providers in the country. Most countries have chosen to set up new entities but under the umbrella of the existing infrastructure of social security or tax collection entities. Sweden for example chose to set up a new entity called the PPA under the aegis of the National Social Insurance Board (NSIB) which managed the old DB pension scheme. In Kosovo, the CRA called the Pension Savings Trust was established as independent legal entity for the purpose of administering and managing Individual Retirement Accounts. Mexico too opted the route of setting up a new CRA. Poland however, gave the mandate of record-keeping of the DC system to the ZUS which was the agency managing the old DB system. The difference between Sweden and Poland was that in Sweden the new entity was specifically designed with the purpose of handling the individual account system and therefore more geared up and empowered to meet the challenges thrown up by the DC system. ZUS on the other hand got mired into its current function and failed to perform as well. ZUS was also not given sufficient time to set up its systems and this resulted in it being unable to carry out a thorough model design process or to correct the inconsistencies in the system.

One of the fundamental issues in setting up the CRA is the cost incurred in doing the same.

## 3 Ownership of the CRA

Ownership of the CRA becomes an issue due to the fact that the CRA is the repository of the most important piece of information in the pensions business. Also it is a monopoly and therefore a potential threat to the cost and efficiency of the system. The monopoly issue can be handled either by ownership resting in government hands or by the government renewing the license or the concession agreement at periodic intervals or a mixture of private and public ownership. Government ownership and administration raises issues of efficiency in management.

Agencies in Sweden, Poland and Belgium are government agencies. Mexico on the other hand insisted that the CRA should be a joint stock company governed by law and the subscription of the stock should only be made by the PFMs and collection offices participating in the retirement savings system. Mexican laws also insisted that the CRA would not be able to redistribute

profits, thus resulting in the pension fund managers themselves starting up a joint stock company called PROCESSAR. The key feature of the Mexican system is that the database is the property of the government and the CRA is just the operator of the database. By segregating the ownership of the database and the administration of the database, the Mexican authorities managed private management with ownership of the database still in government hands. In Turkey the EGM as the CRA is called there, has the government and the eleven pension fund management companies as its shareholders.

## **4 Regulation of the CRA**

Old age security is a highly sensitive issue and one would expect strong regulatory hold over the systems. The functioning of the CRA and its pivotal position in the system makes it crucial that the CRA does not malfunction. Keeping this in mind most countries have empowered the regulators w.r.t the CRA. The regulator has to be sufficiently empowered to oversee the functioning of the CRA.

In Mexico for example the CRA has to report to CONSAR- the pensions regulatory agency. In Sweden too the PPA is regulator by the State Financial Supervisory Agency. The Polish pension system is again a case in point- the ZUS was not regulated by any one entity as a result of which it did not achieve the efficiency that the Swedish and Mexican CRA could. The CRA in turn deals with entities such as collection agencies, fund managers more closely and could play a role of supervising the functioning of these entities. In Sweden the fund managers have to sign a co-operation agreement with the CRA that outlines the rules and obligations of the fund managers.

## **5 System design of the CRA**

One of the fundamental pre-requisite of a successful record-keeping agency is its ability to match the contributions by the individuals to their account numbers without any errors. It is the premise of the individual account philosophy that benefits be linked to contributions and any mistake in this process has serious ramifications for the viability of the system. The Polish system for example has faced several problems because of the non-existence of unique ID numbers. In Mexico too, there was a large sum of unclaimed money that could not be identified to the contributor and hence could not be passed on to the fund manager. This money was put in a suspense account and the account grew up to a size of about \$3 million. Countries that already have social security mechanisms in place have found it relatively easy to use the existing social security number or tax number as an individual account number. In Kosovo for example, the Tax Administration Identifi-

cation document is widely used. In countries like India however where there is no concept of a single individual number special attention will have to be paid to the establishment and functioning of the unique ID generation system.

## **6 CRA charges**

The terminal contributions of an individual are heavily influenced by the charges that he pays towards maintenance and administration of his account. One of the attributes of a central recordkeeping source is low costs of functioning. Though the fees of the CRA per transaction are not known, it is seen that the CRAs have been able to keep administration costs low. Because the CRA is a wholesale customer of the fund managers, the CRAs have also managed to obtain discounts from the fund managers and been able to pass them on to individual customers. Sweden has been able to do this very successfully by mandating a discount schedule to all fund managers desirous of participating in the system.

India has many lessons to learn from international precedents. Care should be taken to set up IT systems with a holistic view of the pension system integrating all the entities. The ID number generation system should be foolproof. The regulator should be well empowered to watch over the CRA and timely rectify any inconsistencies in its operations.