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FEATURED Q&A

What Pension Reforms Does the Region Need?



In June, Chilean President Michelle Bachelet signed a measure to create a state alternative to privately administered pension funds. Many pension contributors receive returns that are too low for their needs, she said. // File Photo: Chilean Government.

Q Chile's 'Bravo Commission,' which President Michelle Bachelet established last year, is due to make recommendations in August on ways to improve the country's pension system. The commission is studying the country's pensions amid concerns about the sustainability of the funds' yields. In Chile and elsewhere in the region, what are the biggest challenges faced by pension funds, and how well are governments reacting? What do demographic trends in the region mean for pension funds? What opportunities exist for private companies in Latin America with regard to pensions, and what more can regulators and government officials do to create a more successful pension system for citizens?

A Milko Matijascic, researcher at the Institute of Applied Economic Research (IPEA) in Brasília: "In Chile, defined contribution pension systems with individual accounts were introduced by the Pinochet administration in 1981, and similar initiatives were later adopted in countries such as Argentina, Uruguay, Colombia and Mexico in the 1990s. The idea was to reduce the fiscal load of defined benefit pay-as-you-go systems, stimulate regular contributions and promote economic growth based on savings. It is now clear that these goals have not been reached as a very large number of senior citizens were unable to contribute enough to be eligible for decent pensions. A previous reform, in 2008, introduced social assistance support for low-income contributors in Chile, which reaches 60 percent of households. In Latin America more broadly, we have seen two kinds of reforms recently where some countries like Peru and Mexico have

Continued on page 6

TODAY'S NEWS

BANKING

Moody's Affirms Stable Rating for Peruvian Banking System

The ratings agency said it based the decision on the assumption that the fundamentals of country's banks will be maintained amid solid economic growth.

Page 2

INSURANCE

Latin American Insurance Premiums See Slower Growth

Premiums grew 4.1 percent last year, a slower rate of growth than the 5.7 percent increase in 2013, according to reinsurer Swiss Re. Life premiums in Latin America increased 3.3 percent to \$75 billion, the company said.

Page 2

BANKING

Banco de Chile Buying Penta's Credit Portfolio

Banco de Chile, led by CEO Arturo Tagle Quiroz, is planning to buy assets of Banco Penta, a source told Reuters.

Page 2



Tagle // File Photo: Federación de Sindicatos del Banco de Chile.

BANKING NEWS

Moody's Affirms Stable Outlook for Peru Banking System

Moody's Investors Service on June 24 affirmed its stable outlook for Peru's banking system on the assumption that the Andean nation's banks will maintain sound fundamentals amid moderate economic growth this year and next. "The Peruvian banks continue to generate



Liquidity and capital buffers also remain strong."

— Jeanne Del Casino

healthy earnings, owing to strong loan demand, stable low-cost core funding and effective control of asset quality and operating costs," said Moody's vice president and senior credit officer Jeanne Del Casino, a member of the Financial Services Advisor's board. "Liquidity and capital buffers also remain strong," she added. Moody's expects Peru's overall economic growth to be between 3 and 4 percent this year and pick up to around 4.5 percent next year given expansionary fiscal and monetary policies, growing private consumption and a pipeline of government-promoted infrastructure and mining projects. The main risks to banks' asset quality are a rise in credit delinquencies by consumers and small- and medium-sized enterprises in addition to significant dollarization, which stands at about 50 percent of deposits and 40 percent of loans. However, strict origination standards and a shift to higher-quality loans as well as a reduction in local currency reserve requirements, which has stimulated lending in soles, help to mitigate those risks, Moody's said. In related news, Peruvian financial regulator SBS on June 18 intervened in the

case of Caja Rural Señor de Luren, a small savings and loan institution that lost more than 50 percent of its regulatory capital in the past 12 months due to insolvency issues and poor risk management, La República reported. On June 19, SBS separated performing assets from the non-performing assets of CRAC Luren, one of Peru's smallest financial institutions, and held an auction in an effort to prevent losses to creditors and depositors after determining that losses were likely to continue, Moody's said in a research note issued on June 26. "The SBS's prudential oversight illustrates the regulator's proactive approach to ensuring a sound financial system," analyst Jaime Reusche said. [Editor's note: See related [Q&A](#) in the June 4-17 issue of the Financial Services Advisor.]

INSURANCE NEWS

Growth in Latin America Insurance Premiums Slows in 2014

Latin America insurance premiums saw growth of 4.1 percent last year, a decline from an expansion of 5.7 percent in 2013, reinsurer Swiss Re said in a recent study, Business News Americas reported on June 26. Life premiums in the region were up 3.3 percent in the year to reach \$75 billion, while non-life premiums grew 4.7 percent to total \$113 billion. Overall, total insurance premiums across Latin America reached \$188 billion in 2014. The market's growth in both sectors was below the 2009-2014 average of 8.5 percent for life insurance and 5.8 percent for non-life premiums. Total premiums in Brazil, the region's largest insurance market, grew 5.9 percent to \$85 billion, with life and non-life premiums increasing 5.4 percent and 6.5 percent respectively. Growth in Brazil's insurance industry has been driven by an increase in the middle class and disposable income as well as increasing FDI and economic stability, analysts told the Advisor in April, adding that near-term growth in the nation's

NEWS BRIEFS

Corpbanca Shareholders Approve Takeover Offer from Brazil's Itaú

Shareholders of Chile's Corpbanca on June 26 approved a \$1.8 billion offer to merge with the Chilean operations of Brazil's Itaú Unibanco, Reuters reported. The deal would create a new Latin American banking venture worth some \$8 billion. The approval is "a decisive step" toward positioning Itaú as a regional banking leader, CEO Roberto Setúbal said in a statement.

Italy's UniCredit Eyeing Expansion in Latin America: CEO

The CEO of Italian financial services company UniCredit, Federico Ghizzoni, said June 22 that the company is reviewing its business plan as interest rates could stay low for longer than expected and erode its planned margins, but that the bank still plans to expand its presence in Latin America as well as China and the Middle East, The Wall Street Journal reported. UniCredit would not acquire lenders in those regions, but would make commercial agreements with local banks in countries where it hopes to expand its presence, Ghizzoni said.

Banco de Chile Agrees to Buy Penta's Credit Portfolio

Banco de Chile, one of the nation's largest banks, last week agreed to buy the credit portfolio of smaller Banco Penta, a source with knowledge of the deal told Reuters on June 30, contradicting an earlier report in local newspaper Diario Financiero that Banco de Chile had offered to pay \$235 million for a number of Penta's key assets. Banco de Chile has been negotiating with Penta since January. Penta is selling off a number of assets at the same time its owners are being investigated in connection with alleged illegal campaign financing.

insurance sector might be weighed down by a difficult macroeconomic environment. In contrast to Brazil, Mexico last year saw overall insurance premiums shrink 0.1 percent, with non-life premiums contracting 1.4 percent to \$15 billion and life premiums expanding 1.4 percent to \$13 billion. Total insurance penetration across the region was 3.1 percent at the end of last year, with Brazil recording 3.9 percent insurance penetration and Mexico a much lower 2.1 percent. "Brazilian insurance penetration remains low, equaling just 4 percent of GDP, suggesting that the country's insurance sector still has significant room to grow, both in terms of its own development, as well as the take-up rate among customers," Diego Kashiwakura, vice president and senior analyst in the Financial Institutions Group at Moody's América Latina in São Paulo, told the Advisor in April. Swiss Re expects growth in life premiums this year to be supported by a rebound in Mexico due to pent-up demand in the middle class as well as more stable growth region-wide. However, the reinsurer expects growth in non-life premiums to remain weak given the lack of underlying momentum in most countries. [Editor's note: See related [Q&A](#) in the April 9-22 issue of the Financial Services Advisor.]

Pactual, BofA Merrill Lynch Eyeing Spot for IRB Brasil's IPO

Grupo BTG Pactual and Bank of America Merrill Lynch are competing to fill the last slot in the group of investment banks handling the initial public offering of Rio de Janeiro-based IRB Brasil, the nation's largest reinsurer, three sources with knowledge of the matter told Reuters on June 24. Those already chosen include Banco do Brasil, Itaú Unibanco Holding and Banco Bradesco, and JPMorgan Chase & Co is the global coordinator, according to the sources. Last year, BTG Pactual was Brazil's largest equity underwriter, while Bank of America Merrill Lynch consistently ranks in the top five, according to Thomson Reuters and Anbima data. Sources said that IRB expects the IPO to raise

about 3 billion reais (\$971 million). Brazil's federal government currently holds a 27 percent stake in the reinsurer. State-run banks Banco do Brasil and Bradesco each hold about 20



Paixão // File Photo: IRB.

percent in the company, and Itaú holds about 15 percent. The banks are hoping to partially or fully exit their stakes, sources said. Brazil's insurance sector is growing despite headwinds in the nation's economy, and plans for an IPO for the insurance branch of state-run Caixa Econômica Federal are also underway, sources recently told Reuters. IRB is looking to expand more in Latin America and Africa, which could require an IPO or an outside partner in the next few years, CEO Leonardo Paixão said in March.

MONEY TRANSFER NEWS

Western Union, BANSEFI Agree to Expand Network

Western Union, the world's largest money-transfer company, announced June 29 that it has reached an agreement with Mexican state-owned development banking institution Banco del Ahorro Nacional y Servicios Financieros, Sociedad Nacional de Crédito, Institución de Banca de Desarrollo (BANSEFI) to expand inbound money transfer services across the nation. Under the new agreement, Western Union and BANSEFI customers will be able to receive money transfers in more than 471 BANSEFI locations across 32 states, expanding access to inbound money transfer services under the Western Union, Vigo and Orlandi Valuta brands. Western Union's Mexico network currently has

more than 10,000 agent locations. "We are delighted about the alliance with BANSEFI that allows us to expand the access and convenience for our customers in Mexico to receive financial support in minutes from their loved ones particularly from the United States. We continue Western Union's expansion in Mexico, with our focus on being close our customers," said vice president and general manager of Western Union Mexico Rodrigo García Estebarena. Mexico is the world's fourth-largest destination of remittances, according to World Bank data, and more than 90 percent of remittances originate from the United States, Western Union said. In 2014, the country received \$23.64 billion dollars in remittances. On June 1, a research note from Goldman Sachs reported that dollar remittances to Mexico this year grew four percent during January through April compared to the same period in 2014. Workers' remittances to Mexico have been growing since the second half of 2013, but in absolute terms have only recently surpassed the levels reached in 2007, in the period just before the global financial crisis.

PENSIONS NEWS

Brazil's Rousseff Proposes Pension System Changes

Brazilian President Dilma Rousseff on June 18 proposed changes to the nation's pension system that Finance Minister Joaquim Levy said would save the nation 50 billion reais (\$16.33 billion) through 2026, The Wall Street Journal reported. The country's pension system currently uses a 85/95 formula, which means that a woman can retire and request a pension when her age and years of contributing to the system total 85, while men can retire when the total reaches 95. Levy said rises in life expectancy make the changes necessary, and Planning Minister Nelson Barbosa and Social Security Minister Carlos Gabas said the revised formula would help prevent a breakdown of the social security system as the size of the work-

ing population relative to retirees decreases. However, Levy said deeper reform “could take years to be implemented.” The measure must pass Congress, where Rousseff has had some difficulty in passing austerity measures. On June 17, Rousseff vetoed a Congressional bill that used the 85/95 formula. And on June 24,



Rousseff // File Photo: Brazilian Government.

the lower house of Brazil’s Congress passed legislation that would boost pension expenditures in future years, Reuters reported. The measure calls for an annual readjustment of pensions using a formula that the government currently uses to raise the minimum wage. Rousseff’s government has opposed using the minimum-wage formula for pensions, arguing the government cannot afford it.

POLITICAL NEWS

United States, Cuba Will Reopen Embassies: Obama

U.S. President Barack Obama announced July 1 that the United States and Cuba will normalize diplomatic relations, including the reopening of embassies in each other’s capitals. “This is a historic step forward in our efforts to normalize relations with the Cuban government and people and begin a new chapter with our neighbors in the Americas,” Obama said in a speech in the White House Rose Garden. “Nobody expects Cuba to be transformed overnight, but I believe that American engagement through our embassy, our businesses and most of all through our people is the best way to advance our interests in support for democracy and human rights.”

ADVISOR Q&A

Did Leaders at the EU-CELAC Summit Achieve Anything?

Q During a two-day summit in Brussels in June, Latin American and European leaders discussed cooperation on trade and other issues, with Europe pledging investments and support for sustainable development in Latin America and the Caribbean. What were the most important achievements of the summit? How well is Europe developing its economic interests in Latin America amid competition from other areas such as China? How significant was the European Union’s agreement at the summit to allow Colombians and Peruvians to visit Europe without visas?

A Joaquín Roy, director of the European Union Center of Excellence at the University of Miami, where he is the Jean Monnet

chair ‘ad personam’: “This summit reflected a steady mood of confirming trends and applying a dose of prudence. Both parties agree on shared objectives regarding peace, progress and the search for finding solutions to ameliorate the development gaps across the Atlantic. The general European scene was mostly dominated by the pressing problems caused by the Greek crisis, security issues provoked by uncontrolled migration and Russia, and the plans for a U.K. referendum on membership in the European Union. In this context, the Latin American countries opted for muting sources of disagreement and complaints. Some even preferred to

abstain from attending, accepting that media attention in Brussels could not match the limelight of the recent Summit of the Americas held in Panama. Venezuelan leader Nicolás Maduro opted for staying home and tending to urgent pressures, while Cuban President Raúl Castro delegated his functions, knowing very well that the plan for dismantling the European Union’s Common Position is on schedule. While the process of the agreement with Mercosur maintains the same uncertainties, progress of the association with Central America is a winner, and a consolidation of the relations with the Caribbean countries is set. While the Andean Community’s future is in doubt, two winners of the group are Peru and Colombia with the waiver of the visa need to travel to the European Union, a measure that may be expanded to other Latin American countries. Prospects for expanded investment are back with European Union funds allotted for the business areas destined to strengthen European presence in a region increasingly under the influence of China. Brazil’s leadership is always on the horizon. A wider context is also connected with the future impact of the planned E.U.-U.S. trade and investment partnership (TTIP).”

EDITORS NOTE: The above is an excerpt of the Featured Q&A published in the June 22 issue of the Dialogue’s daily Advisor.

Just hours before the announcement, Jeffrey DeLaurentis, the chief of the U.S. interests section in Havana, hand delivered to Cuba’s interim foreign minister, Marcelino Medina, a letter from Obama to Cuban President Raúl Castro about the re-establishment of diplomatic ties. Cuba’s Foreign Ministry said the U.S. embassy in Havana would open on July 20. U.S.

Secretary of State John Kerry will be on hand to “proudly raise” the U.S. flag over the embassy, Obama said in his announcement. The announcement came 54 years after the United States severed diplomatic relations with Havana in the wake of the Cuban Revolution and six months after Obama and Castro announced the historic thaw between the two nations.

NEWS BRIEFS

U.S. Senator Makes Surprise Visit to Venezuela to Meet With Opposition

U.S. Sen. Bob Corker (R-Tenn.), the chairman of the Senate Foreign Relations Committee, on June 30 made a surprise visit to Venezuela where he met with members of the opposition, opposition leader María Corina Machado said on Twitter, the Associated Press reported. Corker's office and the U.S. Embassy in Caracas did not respond to requests for comment, so it is not known if the senator will also meet President Nicolás Maduro or government officials.

Scioli Surges Ahead of Nearest Rival for Argentine Presidency

A new poll released June 29 shows Argentina's ruling party candidate for president in October's elections, Daniel Scioli, has surged ahead of his closet rival by more than 8 percentage points, Reuters reported. Scioli, with the Front for Victory party, has 35.1 percent of voter intentions compared with 26.9 percent held by right-of-center Buenos Aires Mayor Mauricio Macri, his closest rival. The poll of 1,200 voters conducted by Ricardo Rouvier & Associates had a margin of error of 3 percentage points.

Chile's Bachelet Names New Cabinet Ministers

Chilean President Michelle Bachelet has appointed Nicolás Eyzaguirre, her former education minister, to be the new head of the general secretariat of the presidency, La Tercera reported June 27. The key cabinet post had been vacant for 20 days after former congressman Jorge Insunza resigned over questions that arose about consulting work he had done for a mining company. Bachelet has named political veteran Adriana Delpiano as her new education minister with a mandate to carry out controversial education reforms.

U.S., Brazil Vow to Fight Climate Change

The United States and Brazil on June 30 pledged to work together to reduce the impact of climate change and announced plans to reduce trade barriers and increase cooperation in other areas during a long-delayed visit by Brazilian President Dilma Rousseff to Washington, The Wall Street Journal reported. The announcement marks a small step forward for the nations ahead of a December meeting in Paris where U.S. President Barack Obama is hoping a global climate change accord will be reached. Both countries pledged to increase the share of renewable energy other than hydropower in their matrixes to 20 percent by 2030, and Brazil additionally committed to eliminating illegal deforestation and restoring 12 million hectares by 2030. The United States has submitted a plan for the December meeting to cut greenhouse gases between 26



Rousseff and Obama met June 30 at the White House // Photo: Brazilian Government.

and 28 percent by 2025 based on 2005 levels. Brazil has not yet submitted its climate-change plan, but Brian Deese, a senior adviser to Obama who focuses on climate change, said the June 30 announcement "reflects the strong commitment of the two presidents to reaching an ambitious climate-change agreement." Rousseff's visit was a step down from the state visit that had been scheduled to occur in 2013, but was canceled in the wake of revelations that the U.S. National Security Agency had spied on her personal communications. The leaders June 30 downplayed any remaining discord. They also announced a new U.S.-Brazil climate-change working group and agreed to boost cooperation in areas including military exchanges and cybersecurity.

ECONOMIC NEWS

Puerto Rico Default Looks Likely as Debt Deadline Looms

Facing a July 1 debt payment deadline without enough money in the bank, Puerto Rico's governor, Alejandro García Padilla, for the first time on June 29 conceded that the U.S. commonwealth's debt was "not payable" and suggested that he would seek significant concessions from many, if not all, of the island's creditors, The New York Times reported. Markets took the news seriously, with the price of some Puerto Rico general obligation bonds declining as much as 12 percent to about 68 cents on the dollar in trading on June 29 one of the largest declines in recent months, according to the Times. In a televised speech that night, García Padilla said the U.S. commonwealth can't pay its \$72 billion in debts and called for a negotiated agreement with bondholders to delay payment for "a number of years," The Wall Street Journal reported. "We cannot allow the situation to force us to choose between paying our creditors and paying our policemen, teachers and nurses," he added. Puerto Rico has added teachers to public payrolls despite a drop in enrollment by 40 percent over the past 10 years, according to media reports. García Padilla also called for lawmakers in Washington to allow for protections under Chapter 9 of the bankruptcy code, proposed legislation that has been stalled in the U.S. Congress. Meanwhile, the Obama administration has said it will not provide a bailout for a debt burden that ranks only behind much more populous states such as California and New York. "There's no one in the administration or in D.C. that's contemplating a federal bailout of Puerto Rico," White House press secretary Josh Earnest said on June 29, The New York Times reported. "But we do remain committed to working with Puerto Rico and their leaders as they face serious challenges." [Editor's note: See ["Is Puerto Rico Headed for a Massive Default?"](#) in the June 10 issue of the Dialogue's daily Latin America Advisor.]

FEATURED Q&A / Continued from page 1

expanded non-contributory pensions, and others, like Argentina, have ended their defined contribution scheme. The coexistence of different pillars or tiers has become a new paradigm, and the coexistence of multiple institutions to provide pensions seems to be inevitable.”

A **Tapen Sinha, professor of risk management at the Instituto Tecnológico Autónomo de México and professor at the University of Nottingham Business School:**

“The biggest challenges of the pension systems in any country are the coverage of the system and the replacement rate that the system provides. The region as a whole suffers from lack of coverage for one simple reason: Most workers in the region work in the informal sector. Even in the best of the cases like Chile, Costa Rica and Uruguay, the coverage of the system is far from 100 percent. So the biggest challenge has been the coverage of the workers in the informal sector. There is a lot of movement between the informal and the formal sector in a country. If noncontributory pension payment is high, the incentive to work in the formal sector gets weaker. The second problem for the people who are in the formal sector contributing to their own defined contribution is that they do not contribute sufficiently to get a replacement rate of 70 to 80 percent. Governments in the region are struggling with both of these problems. High required contribution rates will further weaken the incentive to join the defined contribution plans as they are mostly seen as taxes rather than saving for retirement. Most people in most countries have short planning horizons. One way governments can help is by educating people. We know that general education does not necessarily help pension planning. Financial education does a better job. Therefore, direct education about pensions is the best bet. However, in a region where the general education level is not high, it is not easy to teach people about their needs for old age.”

A **Beatrice Rangel, director of AMLA Consulting in Miami Beach:** “All pension funds in the region face three sets of challenges going forward. First, macro-economic stability builds the middle class. Middle-class families are smaller. Over time, this changes the shape of the demographic pyramid, reducing the number of young people making contributions to pension funds. Funds available for retirement shrink, thereby increasing pressures in favor of deficit spending in the public sector, which threatens macroeconomic stability. Second,

“**Governments must not only keep macro-economic stability, but also create incentives to increase and diversify savings.”**

— Beatrice Rangel

as the world economy transitions from manufacturing to information-based economic activities, volatility is bound to happen, and this poses a lot of pressure on investment returns. In short, it is difficult to preserve the extraordinary rates of return of the past over the next decades, given that stability will not be the defining characteristic of capital markets. Third, the ability of workers to participate and make contributions into the system affects the retirement accumulation. On the plus side, administrative fees are going down, which enhances the flow of disposable income for retirement. But in order to successfully navigate future economic waters, governments must not only keep macroeconomic stability, but also create incentives to increase and diversify savings. Such incentives include equity participation in privatized ventures, shared value practices and development of mortgage markets.”

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