ARGENTINA FINANCIAL SERVICES SECTOR PROGRAM

(AR-0266)

EXECUTIVE SUMMARY

Borrower: Government of Argentina

Executing agency: Ministry of Economy, Secretary of Finance

Amount and Source: [1]

IDB Sector Loan: (OC)	US$ 500,000,000
Technical Cooperation (TC) Loan	US$ 2,000,000
Local Counterpart of TC Loan:	US$ 200,000

Financial terms and conditions :

	Sector Loan	Technical Cooperation Loan
Amortization Period:	20 Years	20 Years
Grace Period:	5 Years	15 Months
Disbursement Period:	12 Months	15 Months
Interest Rate:	Variable	Variable
Supervision and Inspection:	1%	1%
Commitment Fee:	0.75%	0.75%
Currency:	US Dollars from the Single currency facility	US Dollars from the Single currency facility

Objectives: The proposed Financial Services Sector Program would support Government's efforts to implement major reform measures in the pension, insurance, and capital markets. The objectives of the reforms are to: (i) promote a competitive and financially sound market place; (ii) foster the delivery of high-quality and cost-efficient financial services to individual consumers and enterprises; (iii) improve governance of institutions and corporations; and (iv) strengthen and bring up to international standards the regulatory functions and enforcement capabilities of regulators.

Description: The Program is comprised of a fast-disbursing sector loan which would support the execution and implementation of major reforms in the pension, insurance and capital markets. It would be disbursed in two tranches of US$250 million each and would be available upon submission of evidence satisfactory to the Bank that the first and second tranche conditions had been met. The operation also calls for technical cooperation consisting of a technical cooperation loan of US$2 million.

[1] Details of the Technical Cooperation Loan (AR-0284) are provided in Annex III.

The technical cooperation loan would finance a series of studies that would provide a basis for second tranche policies and future reforms in the financial services markets, as well as finance the operations of the project implementation unit. The Program would be organized in four components: (i) macroeconomic framework; (ii) pension system reforms; (iii) insurance sector restructuring; and (iv) capital markets development.

Conditions for Disbursement of the Sector Loan:

The pension system conditions for first tranche disbursement (listed in Section B.2 of Chapter II) are: (a) Prepare and present to Bank a satisfactory plan to amend the pension system legal framework to: (i) authorize AFJPs to offer more than one fund to pension plan members; (ii) permit the elimination of the Stabilization Fund and credit funds to members' accounts; (iii) increase flexibility of investment policy by empowering the regulator to change the limits per category of investments up to 10 percentage points in any direction; (iv) increase flexibility in investment in shares; (v) introduce a commission structure for the AFJPs which is transparent and eliminates fixed fees; and (vi) eliminate the ceiling for lump sum withdrawal upon retirement (para. 2.11). **The conditions for second tranche disbursement** are: The basic legal framework for the pension system is in force and regulations have been issued and are in effect on: (i) content and design of the information to be regularly provided to affiliates (SAFJP); (ii) the ways that the AFJPs will be ranked monthly based on commissions costs (SAFJP); (iii) making investment policy more flexible including changing percentages and criteria for investing in shares (SAFJP); (iv) the characteristics of the new funds to be offered by the AFJPs to affiliates (Executive Power and SAFJP) (para. 2.12).

The insurance component conditions for first tranche disbursement (Section B.3 of Chapter II) are: (a) Introduce changes in the normative framework to settle and liquidate all claims of insurance companies against INDER (para. 2.15); (b) Agree with the Bank on the criteria to be used for the on-site comprehensive financial review to assess the actual net worth of general insurance companies and group them into categories and complete the review of at least one company (para. 2.17); and (c) Complete and present to the Bank a self-assessment to evaluate the degree of compliance with IAIS principles (para. 2.19). **The conditions for the second tranche** are: (a) Settle 100% of claims against INDER of companies accepting Option 1 (see para. 2.15) and pay in cash at least 28% of the total settled sum (para. 2.16); (b) Complete on-site reviews of at least 25 property and casualty insurance companies using criteria developed as a first tranche condition; (c) Prevent insurers with zero or negative net worth from issuing new or renewing existing insurance coverage; (d) Maintain norms requiring

that undercapitalized companies be given not more than four months for compliance (para. 2.17); (e) Present to Bank an action plan for convergence of regulatory framework towards international standards having completed at least the implementation of the Supervisory Ladder (paras. 2.20 – 2.21).

The capital market component conditions for first tranche disbursement (Section B.4 of Chapter II) are: (a) Put into effect the legal framework relative to transparency and corporate governance standards consistent with OECD principles for publicly-traded companies, which is satisfactory to the Bank; (b) Complete and present to the Bank a self-assessment to evaluate the degree of compliance with IOSCO principles (para. 2.25). **The conditions for the second tranche** are: (a) The legal framework relative to transparency and corporate governance standards consistent with OECD principles for publicly-traded companies is in force and key regulations are in place (para. 2.25) and, (b) Present to Bank and announce to the public a Capital Market Policy Document satisfactory to the Bank including at least the following areas: (i) enforcement capabilities of the Securities Regulator; (ii) requirements for issues in primary markets; (iii) structure and governance of secondary market institutions; (iv) clearing and settlement structure.and guarantee systems; (v) entry requirements for intermediaries in different markets; (vi) prudential risk management requirements for intermediaries and market institutions; (vi) standards for internal organization and operational conduct for intermediaries and market institutions; and (vii) tax treatment among different financial instruments and services (para. 2.26).

Bank's country and sector strategy:

The Bank's economic and social growth strategy for Argentina for 2001-2003 period focuses on four objectives: (i) foster sustainable economic growth through raising the level of productivity promoting a favorable environment for investment and increasing competitiveness; (ii) reduce poverty and increase the quality of life of the population by raising employment opportunities and expanding coverage of basic social services; (iii) deepen the modernization of the national public sector and broaden reforms to encompass the provincial and municipal administrations, and (iv) deepen regional integration.

The proposed Financial Services Sector Program would contribute directly to objective (i) and indirectly, to objectives (ii), (iii) and (iv). The Program would foster more active competition between market participants in the domestic and regional financial markets and would help reduce the operating costs of companies providing financial services. It would enhance the process of savings mobilization and

investment and improve protection of investors' interests and consumers' decision-making through increased transparency of transactions and timely provision of financial information. It would also support measures to strengthen and bring up to international standards the supervisory functions and enforcement capabilities of the regulatory agencies. Additionally, it is expected that implementation of the Program would help the financial markets expand and open more employment opportunities.

Environmental/ social review: The CESI has concluded that the proposed Program will have no direct environmental or social impact because all initiatives will be limited to legal and institutional reforms affecting the financial sector.

Benefits: The policy measures supported by the Program are expected to contribute to improve competition among providers of financial services, which in turn should benefit consumers and investors through the availability of a wider choice of pension, insurance, and other saving and investment instruments. Enhanced competition should also lead to more efficiently priced, higher quality financial services.

By requiring that financial services providers disclose more complete information on pension plans and insurance products, the Program will also better protect the property rights of consumers and investors. Minority shareholders would benefit from access to more transparent financial statements and enhanced rules of corporate governance.

The measures would help expand the fraction of the work force covered by retirement plans, the number of people protected by insurance policies, and the volume of transactions in the security markets. The expansion of these markets would generate value-added in the financial sector and contribute to raise employment.

Viability and risks: Successful implementation of the Program requires active participation and coordination of efforts between various regulatory agencies and the Program Executing Unit (UEP) within the Ministry of Economy. The risks will be mitigated by the attention provided to coordination, assignment of responsibilities and technical support.

Another risk is associated with the technical capacity to design and implement the reforms associated with the Program. The Technical Cooperation Loan provides extensive support to the executing agency in terms of staffing and expert consultants most notably in the areas of insurance supervision and regulation and capital markets

The success of the Program also depends on the degree of support that

individuals that operate in the insurance, pension, and capital markets. In order to deal with the risks associated with this issue, a special consensus-building effort is being made by the UEP and the Superintendencies to engage and bring forward the contributions that interested parties of the private sector may make during the development of the new regulations and operating procedures. In addition to the events described in paragraph 3.4, the UEP and Superintendencies are planning a series of seminars and conferences to build consensus and exchange views with the private sector in order to build political support for the reforms and legislative changes. The risks of executing and implementing the Program will be mitigated by the arrangement made for coordination, assignments of responsibilities and technical support mentioned above.

The attainment of the Program objectives is also contingent upon the successful implementation of a stable macroeconomic framework. The Government is committed to this goal and is pursuing a program with the IMF which includes macroeconomic measures including redressing the fiscal imbalance as described in Section A of Chapter I. At the moment, the macroeconomic situation poses challenges. However, the Government's commitment to improve the macroeconomic framework and its willingness to take the necessary measures, enhance the likelihood that it will be successful.

Finally, there is the risk that it will be politically difficult to undertake the reforms that are envisaged under the program. While the Government has experienced opposition to reforms, particularly in the face of the poor economic situation, it has been able to move at an accelerated pace to issue decrees on such thorny matters as changing the regulatory and supervisory framework of financial services and solving long-pending matters such as the situation of INDER. The political will of the government to institute these reforms appears unwavering. Although it has been difficult to build political consensus, thus far the record has been good and there is no reason to believe that it would deteriorate or be unsuccessful.

Special contractual clauses for the Sector Loan: Those mentioned under Conditions for Disbursement.

Special Contractual Clauses for the TC Loan:	See Annex III.
Poverty-targeting and social sector classification:	Not applicable.
Exceptions to Bank policy for the Sector Loan:	None.
Exceptions to Bank Policy for the TC Loan:	See Annex III.
Procurement for the Sector Loan:	The fast-disbursing funds from the sector loan may be used to finance the aggregate cost in foreign exchange of eligible imports from the Bank's' member countries. In this case, the Bank's procedures for sector loans, which do not require international competitive bidding, will be applied. The funds would be disbursed when requested by the borrower and evidence is presented that all the contractual conditions have been complied with.
Procurement for the TC Loan:	See Annex III

I. FRAME OF REFERENCE

1.1 During the decade of the 1990s, the Government of Argentina undertook a profound transformation of the country's financial sector that resulted in the creation and rapid development of new institutions, markets, and instruments. This process was accompanied by an impressive growth in the volume of transactions and services to businesses and to the general public. Argentina's Government is currently engaged in a program of second-generation reforms directed to further improve the functioning of the securities, insurance and pension fund markets, create conditions for the delivery of high-quality and cost-efficient services, harmonize and enhance regulation and supervision, and facilitate regional integration and competition with and among other regional and international financial markets.

1.2 This proposed Financial Services Sector Program and its underlying analysis provide a roadmap to support the Government's efforts to undertake these second-generation reforms. It consists of two components: a sector loan and a technical cooperation loan. The technical cooperation loan would support implementation of the sector loan and would also provide some elements for continuing the reform process. The proposed Program is expected to promote a competitive and financially sound market place, foster the delivery of high-quality and cost-efficient financial services to consumers and enterprises, improve governance of institutions and corporations, and strengthen and bring closer to international standards the regulatory functions and enforcement capabilities of regulators.

A. Macroeconomic framework

1.3 During the first half of the decade of the 1990s, Argentina undertook wide-ranging structural reforms of the public sector, opening trade and capital markets, implementing privatizations including partially privatizing social security, diversifying exports and promoting foreign and domestic investment in the local credit and capital markets. These reforms, along with the enactment of the Convertibility Law in 1991, led to the elimination of inflationary pressures, high rates of economic growth and rapid development of the credit, capital, and insurance markets. The pace of reforms slowed down after 1996 and in the face of unfavorable external conditions and financial disturbances, the rate of economic growth was negative in 1995, 1999 and 2000 and the economy entered into a recession beginning in the fourth quarter of 1998. The restructuring process was accompanied by high unemployment and deterioration of social conditions. By October 2000, the economic recession had brought the unemployment rate to 14.7%.

1.4 The Government that took office in December of 1999 launched a set of programs and wide-ranging structural reforms to increase the competitiveness of the economy, facilitate growth of economic activity and employment, and reduce the fiscal deficit in the short run. Based on these objectives, it signed a Letter of Intent with the IMF in February 2000. By mid-2000, however, uncertainties

related to a cabinet reshuffle and significant deterioration of the external environment hindered the implementation of some of the Government's policies.

1.5 In early November of 2000, a set of additional measures was announced, strengthening tax administration, rationalizing public spending, making social security and health systems more equitable and efficient, modernizing labor legislation, promoting job creation and strengthening the domestic financial system. Nonetheless, financial markets became increasingly inhospitable and in late 2000, in reaction to sharply deteriorating access to international capital markets, the Government reinforced its economic team and initiated a new set of economic reforms. To provide a cushion in the face of limited access to financial markets and to bolster confidence, the Government negotiated a package of international financial support which has become known as the "*blindaje financiero,*" literally financial armor plating. This *blindaje financiero* totals approximately US$39.7 billion, with about half from the private sector. Within the framework of economic parameters agreed with the IMF, the package also includes an augmented stand-by arrangement of US$13.7 billion, a commitment of US$1 billion from the Government of Spain and pledges from the Bank and the World Bank of approximately US$2.4 billion each over the years 2000-2002. This Program supports the *blindaje financiero* and represents part of the Bank's US$2.4 billion commitment.

1.6 In early March 2001, the Minister of Economy resigned and a new economic team was brought in. A program designed to cut about $2 billion from the Federal budget was proposed in order to meet the fiscal targets agreed with the IMF and the Law of Fiscal Discipline. To increase credibility the program focused on the expenditure side and on measures within the jurisdiction of the federal government. While the program was well grounded with economic justifications for reducing inefficiencies in federal spending, it failed to receive adequate political backing (leading to the resignation of several cabinet members) largely due to perceived targeting of cuts in education spending.

1.7 By mid- March, this economic team was also replaced. A new team, headed by a former Minister of Economy and the architect of the Convertibility Plan, is now in place and formulating a new program, focused on stimulating economic activity and achieving fiscal balance through a combination of tax increases and cuts in expenditures. Facing a critical fiscal position, the immediate priority has been on revenue generation with longer-term structural reforms in expenditures to follow. One measure implemented has been a tax on financial transactions aimed at improving revenues and liquidity. This tax, which affects the banking sector and its transactions, could have an impact over time reducing the volume of transactions. There has been no study on the impact of the tax at writing, so its effect is not readily apparent. During the first quarter of this year, January – March 2001, Argentina has not been able to achieve the fiscal deficit targets that it had agreed to with the IMF. As a result, a new Letter of Intent has been signed on May 3, 2001 and will be submitted to the IMF's Board within the next two weeks. The new Letter of Intent provides an IMF disbursement of US$ 1.26

billion before the end of the month, a revised and lower estimate for growth of the economy, the inclusion of the *euro* in the convertibility scheme, the reduction of some taxes and an increase in the reserves of the banking sector to 20%.

B. The financial sector

1. Significant developments of the 1990s

1.8 The economic strategy begun in the early 1990s has had a profound and positive impact on the development of the financial sector. The size and scope of the money, credit, equities, bonds, and annuities markets have increased at a rapid pace and reached unprecedented levels by the end of the decade. The number of institutions in the banking system have declined as a result of mergers and acquisitions of weaker banks by stronger ones but, as shown later, the volume of transactions in the insurance industry, new pension funds, and several other participants in these markets has multiplied. The respective regulatory agencies have been revising and strengthening their functions and enforcement capabilities, and improving the technical capacity of their personnel. Norms governing the activities of larger and more complex players have been updated to bring them closer to international standards.

1.9 During the 1990s, financial service reforms were concentrated in the banking sector. Indeed, the Bank's last two financial sector operations, the Provincial Bank Privatization Sector Reform (Loan 865/OC-AR) of 1995, and the Program for Special Structural Adjustment and Strengthening of Banking Safeguards (Loan 1163/OC-AR) of 1998, supported the reform of Argentina's banking system. The reforms included a major restructuring involving privatization, consolidation and closure of institutions, and strengthening of the regulatory and supervisory system.

1.10 One result of the reforms has been increased foreign ownership of the banking system and increased joint ownership and majority control of banks and of other providers of financial services. Several banks in the system are owned by foreign parent companies as subsidiaries, branches or affiliates and a number of domestic banks, including official banks, own branches located abroad. From a systemic risk perspective, the increased foreign ownership has reduced risk in the banking sector, as foreign banks tend to be larger and have higher capital/asset ratios and percentages of performing loans. On the other hand, foreign bank lending is more concentrated toward large customers in metropolitan areas, while public and private domestic banks lend more for primary production activities and government services. The allocation of credit by province and sector indicates that credit markets are fragmented. Moreover, credit allocation by customer size, notably to medium and small enterprises, continues to reflect lack of access by these groups.

1.11 Another result of the reforms has been the emergence of banks that belong to financial groups (conglomerates) which own intermediaries such as pension fund

management companies, insurance companies, investment underwriters, mutual funds, fiduciary funds, and credit card issuers and financiers. These interrelationships require enhanced coordination among the regulating agencies and coherent application of norms and standards. The Bank is supporting this important area through technical cooperation to assess and propose ways to strengthen coordination and application of the norms and standards for conglomerates (Annex III, the Technical Cooperation Loan).

1.12 The Central Bank has introduced a sound system of market-oriented prudential regulations that complement its supervisory responsibilities. The system in place incorporates the current international best practices and operates through financial assessments of investors, private auditors and rating agencies. Indeed, solvency and liquidity requirements exceed the levels recommended by the Basle Committee on Banking Supervision. The resilience of the Argentine banking industry was tested in 1998 during the financial shocks associated with the problems of Asia's southeastern economies, and again in 1999 in relation to the Brazilian Real devaluation, and the uncertainties of a presidential election year and subsequent change of authorities. In all of these instances, the system showed a great deal of reliability and maintained savers and investors confidence.

1.13 Similarly, the prevention of money laundering is a topic which concerns Argentina. On April 13, 2000 the Government passed Law 25,246 which enforces standards and principles to prevent money laundering. The law also created a Financial Information Unit within the Ministry of Justice. This unit is comprised of representatives from the Central Bank, Federal Tax Authority, Superintendency of Capital Markets, Ministry of Economy, Ministry of Justice, and experts from the President's Secretary for the prevention of Drug Addiction and the Battle Against Drugs. Argentina has participated in the Financial Action Task Force (FATF, *Grupo de Acción Financiero* GAFI) on Money Laundering as an observer since September 1999 and was one of the first members to undergo an evaluation by internationally recognized experts last year. As a result of the positive outcome of this evaluation, Argentina was admitted as a full member of the FATF on Money Laundering.

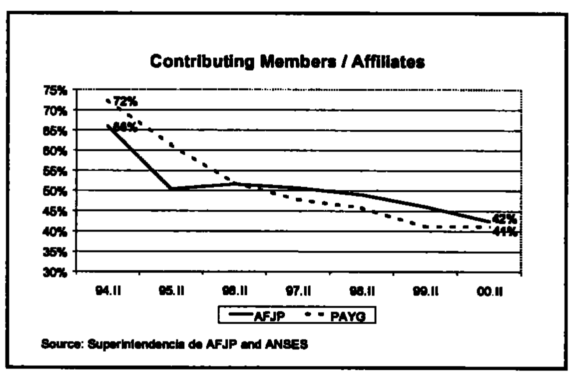
1.14 A number of issues remain that need to be addressed in financial services pertaining, for example, to the structure and organization of the various markets, their depth, the tax regime, and the need to enhance competition, improve transparency of operations and transactions, and better protect investors' interests. In this context, and within the framework of the Financial Stability Forum and its impact on the design of the international financial architecture, the Government of Argentina has launched a second generation of reforms the first stage of which is supported by the proposed operation. The specific focus is the pension system, insurance industry and capital markets which up to now have not been addressed in a systematic and comprehensive way.

2. Pension system

1.15 The pension system (SIJP – *Sistema Integrado de Jubilaciones y Pensiones*) has a pay-as-you-go (PAYG) mandatory pillar, run by the *Administración Nacional de Seguridad Social* (ANSES). It provides a basic benefit (*Pensión Básica Universal* - PBU) which can be claimed by a worker who has contributed for 30 years and reached 65/60 years of age (male/female). A second mandatory pillar provides employees with two alternatives: a defined benefit system (called additional benefit for permanency in the PAYG system) also managed by the ANSES, or a defined contribution system managed by private pension companies (*Administradoras de Fondos de Jubilaciones y Pensiones* – AFJP). There are also voluntary contractual savings schemes privately managed by AFJPs or annuity companies (*Compañías de Seguro de Retiro*) with contributions from employers and/or employees.

1.16 The public pension system is burdened with the cost of transition from a PAYG retirement system to one that includes a funded pillar. In fact, in 2000 the *Régimen Público de Pensiones*[1] generated a deficit of about 4.2% of GDP. The financial position of the *Régimen Público de Pensiones* has been weakening as the rate of contributions and collection has declined. As a result of legislative changes, employers' contributions to the PAYG pillar have declined from 16% in 1994, to 10.4% in 1995, and to about 7.2% by the end of 2000. The ratio of contributing members to affiliates fell from about 70% in 1994, to about 40% in mid-2000. In addition, the outlays of the *Régimen Público de Pensiones* have been increasing in part as a result of increases in the benefits indexation factor which rose from \$61 in 1993, to \$80 in 1997, exceeding the 3% wage increase experienced during the same period.

1.17 In spite of the aging of the population, the number of SIJP beneficiaries is declining. In 1997, the AFJPs had 6.3 million affiliates (representing 70% of total affiliated workers), the PAYG public program had 2.3 million workers, whereas "undecided workers," who had not affiliated with a pension plan, represented 0.3 million. Only 50% of these workers contributed to their pension plans. Today, AFJP affiliates have expanded to 8.3 million, but the ratio of contributors to affiliated workers has declined to about 40%. This decline is associated with several factors: (i) the economic recession of 1999-2000; (ii) the disincentives provided by the system



Source: Superintendencia de AFJP and ANSES

[1] The *Régimen Público de Pensiones* is comprised of the PBU, the Compensatory Benefit (PC) paid to participants in the previous system, the Additional Benefit for Permanency (PAP), and the Old Age Pension (OAP).

(long vesting period and high transactions costs); and (iii) poor collection and enforcement systems.

1.18 The AFJPs are supervised and regulated by the SAFJP (*Superintendencia de Administradoras de Fondos de Jubilaciones y Pensiones)* which was created in 1993 by Law 24.241 (SIJP -*Sistema Integrado de Jubilaciones y Pensiones*). The SAFJP is a financially autonomous entity under the Ministry of Labor and Social Security. It is funded by a percentage of the mandatory monthly contributions to the AFJPs and any fines it may impose on the AFJPs for non-compliance with Law 24.241 and the regulations. The Superintendent of the SAFJP is appointed by the Executive Branch of the government.

1.19 The negative financial impact of the public pension system on the government budget is expected to be reduced through the reforms supported by the IMF Program, and also the Bank's Program to Support the Fiscal Balance and Social Management (Loan 1295/OC-AR) which was approved in December 2000. The reforms include improvements in the public pillar , incentives for vesting periods, and strengthening enforcement of collection of contributions. The proposed Financial Services Sector Program Loan will complement these two programs by reforms of the private pension system as described in Chapter II.

3. Insurance industry

1.20 The insurance industry is comprised of 220 companies. It is dominated by the property and casualty business which has 53% of the market share in terms of premiums. Life insurance, annuities and workers' compensation comprise 25%, 12% and 10%, respectively, of the remaining share of market premiums. Overall, premium income in the insurance industry has grown by 194% between 1990 and 2000. This growth was boosted in part by the implementation of pension reform and the insurance law covering workers' compensation (Insurance Resolution No. 21,521 of 1992). Retirement insurance alone increased from 15 million pesos in 1995 to 735 million pesos in 2000. However, despite the impressive growth, the industry's development potential is still large. In fact, in developed countries premium income averages 7-8% of GDP, compared to about 2% of GDP in 1999 for Argentina.

Statistical Overview of the Insurance Market (December 2000)*

	Number of Companies	Premiums (MM$)	Ratio of Premiums to GDP %
Property & Casualty	116	3,360	1.24
Life Insurance	64	1,660	0.59
Annuities	26	735	0.26
Workmen's Compensation	14	650	0.24
Total Market	220	6,361	2.38

Source: Superintendencia de Seguros de la Nación

(*) The financial years of insurance companies is from July 1 - June 30. Thus, data from July to December 2000 is projected.

1.21 The *Instituto Nacional de Reaseguros* (INDER) was the public agency holding a monopoly of the reinsurance business covering largely property and casualty insurance. INDER has been technically bankrupt since 1991, when it was placed in liquidation as part of the reform of the state. However, the numerous claims

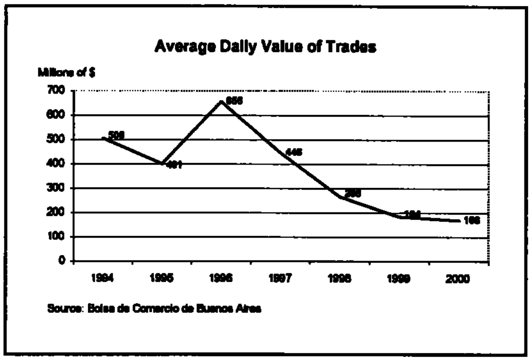
against INDER by insured parties (through their insurance companies), have not yet been settled. Unresolved claims against INDER are estimated at around $540 million, which is a significant proportion of the total capital base of the industry. There have been several attempts in the past to make offers of settlement but none have been successfully pursued.

1.22 INDER's situation impacts the financial viability of the insurance companies (mostly those in the property and casualty business) and people's perceptions about the solvency of the industry, which in turn dampens demand for its services. Additionally, because insurance companies were required to buy reinsurance from INDER, it gave rise to a situation where Argentine insurers had no incentive to develop underwriting, pricing and investment skills. Therefore, when INDER was closed, the industry was unprepared to take on the role of insurance companies within a competitive private enterprise system. Lacking pricing skills, many of these insurance companies wrote high-risk policies for which they were not adequately remunerated. A significant number of insurance companies are suspected to be insolvent (even under the assumption that INDER adequately cancels its obligations with them). The continuing participation of these companies in the marketplace drives under-pricing of insurance services, leads to unprofitable activity for other insurers and further contributes to overall insolvency of the insurance industry.

1.23 The insurance industry is supervised by the SSN (*Superintendencia de Seguros de la Nación)* which was created in 1937 by Decree Number 108.295 and operates under the guidelines of Resolution Number 21,523 of 1992 which made modifications to the insurance industry and its regulation. The SSN is dependent upon the Ministry of the Economy and lacks the financial and operational information and resources required to reasonably assess the financial health of insurers and effectively oversee the solvency and fair practices of insurance providers. Moreover, the existing regulatory framework is in need of changes in order to meet the principles recommended by the International Association of Insurance Supervisors (IAIS).

1.24 Compounding the problem, consumers do not have information adequate to be able to make informed choices concerning the insurer they select, the products they are buying and their rights of redress when there are disputes. As a consequence of this lack of disclosure and transparency, some insurers are in a position to take advantage of policyholders. Such a market conduct by insurers and an inability for consumers to have their complaints handled fairly and efficiently, undermines confidence in the insurance marketplace.

4. Capital markets



1.25 Argentina's equity markets volume lags behind that of other emerging economies with the resulting failure in fulfilling their function of channeling savings towards efficient investments as an alternative to the banking markets. Market capitalization as a percentage of GDP (40%) is low relative to Chile (89%), though higher than in Brazil (30%) and Mexico (35%). The number of companies trading on the exchange has declined from 650 in 1960, to 181 in 1990, and 130 in 2000. The larger Argentine companies now trade through the American Depository Receipts (ADRs) in New York and this volume exceeds the trades on the Buenos Aires floor.

1.26 Argentina's debt market (fixed income) is dominated by the public sector. Its principal instruments are short-term treasury bills (Letes- *Letras de la Tesorería*) with a tenor of 90-180 days) and treasury bonds (Bontes - *Bonos de la Tesorería*) with a tenor of on 1 to 5 years. There are 2 auctions per month which are dominated by twelve active market makers. The AFJPs and international investors are the primary purchasers of public debt. Private debt is quite undeveloped, largely as a consequence of being crowded out by public sector debt.

1.27 The equity market is comprised of the *Mercado de Valores de Buenos Aires* (MERVAL) and the *Bolsa del Comercio de Buenos Aires* (BCBA). The *Caja de Valores S.A.*, which is owned by the BCBA and MERVAL, is the central securities depository for public and private securities. The public debt market is dominated by the *Mercado Abierto Electrónico* (MAE) which has its own settlement and liquidation facility, the *Central de Registro y Liquidaciones* (CRYL).

1.28 MERVAL is Argentina's largest stock market executing about 95% of the securities traded on Argentina's eleven stock exchanges. MERVAL, founded in 1929, is a self-regulating agency owned by its 250 members who also are members of BCBA. It manages the trading and posting of securities through *Sistema Integral de Negociación Asistida por Computadora* (SINAC) or open trading floor, clearing and settlement, and oversight.

1.29 The BCBA has 4000 members, of which only the 250 MERVAL members take part in the market. The remaining members are passive and do not participate in the market's development or strategic planning. Of the 250 MERVAL members, only 50 are actively engaged in the market and execute about 100% of its activities. The members do not feel they are equitably represented in BCBA or MERVAL because their voting shares--50/4000 and 50/250 respectively--do not

give them a voice in the market, its structure, operational improvements and efficiency in proportion to their share of activities.

1.30 Regulation and supervision are in place, but the securities law (Public Offering of Securities Act, Law 17,811), dates back to 1968. Moreover, the *Comisión Nacional de Valores* (CNV) is the official agency responsible for regulation and supervision of capital markets institutions, but the main market players (BCBA, MERVAL and MAE) are all self-regulating bodies. CNV's ability to supervise and regulate this industry is also impeded by discrepancies and lack of consistency among the different regulations pertaining to the sector.

C. Bank's participation in the financial sector and lessons learned

1.31 The Bank's work in the financial sectors of the region has helped reform central banks, prudential regulations, liberalization of interest rates, and improvements in commercial banking aimed at making member countries more attractive to private investors. The financial sector loans of the Bank in Argentina, combined with other programs supported by the World Bank and the IMF, have had a profound impact in supporting the Government's reforms of the financial services sector. The Bank has cofinanced a number of loans with the World Bank including the Program for Special Structural Adjustment and Strengthening of Banking Safeguards Loan 1163/OC-AR of 1998. Recently, Argentina has requested that the IDB undertake all work in the financial sector in the country and the World Bank is not lending in this area. However, the World Bank is intensively involved in the Financial Sector Assessment Program (FSAP) being conducted in Argentina jointly with the IMF.

1.32 The Bank has assisted the Government in designing several sector loans to support the first generation of reforms begun in the 1990s. The <u>first</u>, the Public Sector Adjustment Program (Loan No. 633/OC-AR) approved in 1991, addressed reduction of the public deficit through increasing fiscal revenues and Central Bank financing of the government. The objectives were accomplished satisfactorily as measures were concentrated in a few, important areas.

1.33 The <u>second</u> operation, the Investment Sector Loan (733/OC-AR) strengthened the regulatory framework of the securities markets, the efficiency of public banks and provincial public finances. In retrospect, it included too many reforms, and its main lessons learned were to keep conditionality simple, well-focused and to better reflect the special relationships between provincial and federal levels of government. The <u>third</u> and <u>fourth</u> sector operations for Provincial Bank Privatization Sector Reform (865/OC-AR) of 1995 and Provincial Social Security Reform Sector Adjustment (961/OC-AR) of 1996 continued reforms at the local level, reflecting the lessons learned on the special relationships between different levels of government. The <u>final</u> sector operation supporting the first generation reforms of the 1990s was Loan 1163/OC-AR approved in 1998. It has recently been fully disbursed but it is too early to draw conclusions. Its main objectives were to streamline federal-provincial fiscal sharing arrangements, improve

poverty measurement instruments to enhance social protection and the safety net, improve public utilities regulation capacity and strengthen banking safeguards.

1.34 The main lessons learned from the ex-post assessment of these operations relate to the conditionalities and project objectives. With respect to the former, the lessons learned showed that projects' whose conditionalities were clear, well-focussed and simple were implemented more smoothly. Likewise, projects whose objectives were concentrated in a few key areas were more effectively implemented than those with numerous objectives.

1.35 In the year 2000, the Board approved another sector loan, the Program to Support the Fiscal Balance and Social Management (Loan 1295/OC-AR) which supports the government's efforts to maintain fiscal balance, improve the management of social programs and help increase competitiveness in the labor market. The operation contains a component to improve efficiency and equity in the public pay-as-you-go pension pillar (social security). It also addresses improving management skills and budget performance results for the Ministry of Labor and other agencies, and reducing costs of registering labor contracts and lowering collective bargaining. Finally, the operation provides actions to improve management in national social programs and develop a methodology to evaluate impact on beneficiary families of social programs.

D. The Bank's strategy in Argentina and its financial sector

1.36 The Bank's economic and social growth strategy for Argentina for the 2001-2003 period focuses on four key general objectives: (i) foster sustainable economic growth through raising the level of productivity, promoting a favorable environment for investment and increasing competitiveness; (ii) reduce poverty and increase the quality of life of the population by raising employment opportunities and expanding coverage of basic social services; (iii) deepen the modernization of the national public sector and broaden reforms to encompass the provincial and municipal administrations; and (iv) deepen regional integration.

1.37 The proposed Financial Services Sector Program would contribute directly to objective (i) and indirectly to objectives (ii), (iii) and (iv). The Program would foster more active competition between market participants in the domestic and regional financial markets and would help reduce the operating costs of companies providing financial services. It would enhance the process of savings mobilization and investment and improve protection of investors' interests and consumers' decision-making through increased transparency of transactions and timely provision of financial information. It would also support measures to strengthen and bring up to international standards the supervisory functions and enforcement capabilities of the regulatory agencies. Additionally, it is expected that implementation of the Program would help the financial markets expand and open more employment opportunities.

E. Program rationale

1.38 Although significant progress has been made over the last decade in reforming the pension system and, to a lesser extent, the markets for securities and insurance, a number of issues remain to be addressed. The proposed Program would provide a consolidated approach to reforming these sub-sectors, strengthening the conditions for Argentina to move toward a global economy, and offer competitive and equitable financial services to its people.

1.39 The issues that remain to be addressed pertain to the structure and organization of the various markets, methods to enhance competition among participants, measures to reduce costs, raise operating efficiency, and increase transparency of operations and transactions, standardization of accounting practices, presentation and dissemination of information to shareholders and the public, and better protection of investor's interests.

1.40 In the pension area, the Program will focus on the private pension system and will complement Loan 1295/OC-AR which includes measures to improve efficiency in the public pension system. The private **pension system** is constrained by regulations that hamper competition and contribute to high operating costs. The existing restrictions on investment instruments and portfolio composition of pension funds aim at encouraging diversification, reducing exposure to single issuers, avoiding conflict of interest, and reducing riskier investment. However, as the system has expanded and matured, presently both managers of pension funds and participants confront limited choices to manage portfolios and risks. Additionally, expanding the presently limited information available to participants in pension funds would allow members to make more informed choices about their financial future. Providing this information to members of AFJPs would also foster competition among funds, heighten investment performance and likely lower commissions, which would possibly attract more members and increase contributions to the system.

1.41 In the **insurance market,** the continued presence of several practically bankrupt companies leads to unprofitable activity for other insurers that may be relatively more efficient but can not take advantage of economies of scale. The financially troubled companies also are reluctant to pay claims and use the slow moving court system to their advantage. This undermines confidence in the system and limits growth of the market. The Superintendence of Insurance is also constrained by funding and inability to attract and retain high quality professionals and adequately train its staff. Furthermore, the Superintendency needs to expand the scope of its activities, become a more effective regulator in areas such as investment risk and use internationally established tools such as early warning ratios and benchmarks. Higher standards of corporate governance, in line with international best practice, would enhance the effectiveness and efficiency of the supervisory framework. Some insurance products are marketed without full disclosure of information relevant for would-be policyholders to make informed decisions about the insurer or product they select. In addition, the inability of

consumers to have their complaints handled fairly and efficiently requires active involvement of the regulators to bolster confidence in the insurance marketplace.

1.42 In the **capital markets**, their fragmentation and structure is impeding their ability to provide efficient pricing, clear governance and liquidity. These have led to a decline in the number of Argentine companies listed on the local exchanges, lower trading activity, and lack of confidence of large foreign institutional investors on enforcement of market rules. In addition, the passive role and fragmentation of the three major market players hinders the market's ability to function properly, skews the decision-making process, and limits the opportunities for providing cost-efficient services. Similar structural issues also affect clearing and settlement, where three entities have emerged over time with overlapping functions preventing efficient pricing and liquidity. The CNV's ability to supervise and regulate the equity markets is impeded by the discrepancies and lack of consistency in the regulations. In addition, the CNV is funded from budget resources, which are inadequate to enable it to carry out its mandate appropriately

II. THE PROGRAM

A. Objectives

2.1 The proposed Financial Services Sector Program would support Government's efforts to implement major reform measures in the pension, insurance, and capital markets. The objectives of the reforms are to: (i) promote a competitive and financially sound market place; (ii) foster the delivery of high-quality and cost-efficient financial services to individual consumers and enterprises; (iii) improve governance of institutions and corporations; and (iv) strengthen and bring up to international standards the regulatory functions and enforcement capabilities of regulators.

2.2 The Program would be organized in four components: (i) macroeconomic framework; (ii) pension system reforms; (iii) insurance sector restructuring; and (iv) capital markets development.

B. Description of the program

1. Macroeconomic framework

2.3 In early November of 2000, the Government announced a set of measures designed to reduce the public sector deficit and restore investors' confidence. These measures included reform of the public pension regime, an agreement with the provinces to control provincial deficits, strengthening tax administration, rationalizing public spending, making social security and health systems more equitable and efficient, modernizing labor legislation, promoting job creation and strengthening the domestic financial system. These measures provided the basis

for a new program with the IMF, which was approved in January 2001. The stand-by program with the IMF in the amount of US$13.7 billion will be supplemented with additional resources in the amount of US$26 billion from multilateral and bilateral lenders, and local banks and pension funds. These resources are expected to facilitate a sustained decline in the risk premium of Argentine bonds, and consequently reduce financing costs for public and private borrowers.

2.4 A central aspect of the policy package is the strategy to reduce fiscal deficits at all levels of the public sector with the purpose of effecting a sustained lowering of the public sector debt in relation to GDP over the medium term. The national government budget for 2001 envisages only a modest reduction of the deficit but the Government is committed to revising the fiscal responsibility law to achieve a decline of the deficit in subsequent years leading to a zero deficit by 2005. A similar commitment was agreed with respect to the provincial government deficits in the recent federal fiscal pact.

2.5 The international finance package and the implementation of the policy package are expected to bolster investor confidence and contribute to restoring economic growth and employment. GDP growth is projected to reach 4% in the fourth quarter of 2001, although averaging only 2.5% for the year. Over the medium term, GDP growth is expected to be sustained at around 4%. Inflation is expected to remain lower than in major trading partners, thus helping competitiveness. The external trade surplus is projected to increase in 2001 supported by a sustained growth of exports. As a result, the current account deficit is expected to decline slightly, partly offset by higher net interest payments abroad.

2.6 The proposed Program would support implementation of a macroeconomic policy program that is consistent with a stable environment for execution and implementation of the proposed operation ***(first and second tranches).***

2. Pension system reform

2.7 Despite the gains achieved by the private pension system since the reform of 1994, some weaknesses have emerged that require continued reforms. The main weaknesses are: (i) inefficiencies and inadequate competition; (ii) insufficient protection of members' property rights and restricted ability to manage risk; (iii) inflexible investment regulations; and (iv) underdeveloped voluntary contractual savings systems.

2.8 The pension system's lack of efficiency and competition has resulted in high operating costs relative to comparable countries. For instance, AFJP's are not permitted to pay benefits directly to their participants without first acquiring a benefit certification from ANSES, a step that is both time-consuming and costly. Likewise, the process involved in paying disability benefits requires needlessly time-consuming and costly certification that also results in cross-subsidies

between the retirement and workers' compensation plans. The AFJPs are not required to regularly disclose information on their commissions and rates of return and may use fixed and variable commissions and fees that make it difficult to compare pension funds. At present, there are no penalties for changing to a different fund, but it is clear that lack of satisfactory and regular information impedes change and restricts competition. Moreover, undecided members are allocated among AFJPs on a *pro rata* basis, rather than according to any performance criteria.

2.9 Concerning the regulatory framework for investments there are several issues of risk management that need to be addressed. The <u>first</u> relates to a mandatory Stabilization Fund, which sets aside as reserves AFJPs' returns in excess of the system's average plus 30%. The existence of the Stabilization Fund restricts management of investments and creates a pool of funds which contributors may not get back, infringing their rights of ownership. Moreover, best international practices in countries of the European Union and the United States of America, do not require such funds. The <u>second</u> is that AFJPs can only offer one fund option to members. The possibility of contributing to more than one fund would enhance members' ability to manage their portfolio and risk. The <u>third</u> risk management issue is that the proportion of investment that AFJP's may allocate to different instruments is predetermined by law (e.g., investment in foreign shares may not exceed 7% of the portfolio). This limits the AFJP's ability to manage fund risk. The <u>fourth</u> relates to inflexible restrictions on investment in equity which requires ratings. Since rating of shares is not an international practice, the requirement impairs investment in foreign shares, which is limited to 7% of the portfolio.

2.10 Voluntary contractual saving schemes are still quite underdeveloped in Argentina. Although AFJPs can take voluntary contributions for retirement with the same favorable tax treatment as mandated contributions, they have been unable to mobilize them. One reason is the relative lack of liquidity of these savings until the time of retirement and even at the time of retirement there is a limit for withdrawals of lump sums.

2.11 On January 3, 2001, to expedite the reform process, the Government published in the official gazette its Presidential Decree No. 1306/2000 enacting reforms to redress the deficiencies identified in the previous paragraphs. Currently, this Decree has been suspended awaiting a resolution of the judiciary on some procedural problems and not the contents of the Decree. First tranche conditions require that the Government would prepare and present to the Bank satisfactory evidence on how it will amend the pension system legal framework to address the main issues above, most notably:

- authorizing AFJPs to offer more than one fund to pension plan members thereby providing them with more options and ability to manage their risks;
- eliminating the Stabilization Fund and mandating that funds be credited to members' accounts;

- increasing flexibility of investment policy by increasing investment limits and empowering the regulator to change these limits up to about 10 percentage points in any direction, increasing the investment limit on foreign private securities, and making requirements for investment in shares more flexible;
- increase flexibility in investments in shares;
- eliminating flat fees and commissions moving toward a variable price structure which is a percentage of taxable wages which better enables affiliates to compare prices;
- removing the ceiling for lump sum withdrawals upon retirement.

2.12 For the ***second tranche***, the government will adopt the key measures necessary to make the reforms fully operational, namely the issuance of regulations on:

- content and design of the information to be regularly provided to affiliates (SAFJP);
- the ways that the AFJPs will be ranked monthly based on commissions costs (SAFJP);
- making investment policy more flexible including changing percentages and criteria for investing in shares (SAFJP);
- characteristics of the new funds to be offered by the AFJPs to affiliates (Executive Power and SAFJP).

3. Insurance industry restructuring

2.13 A number of significant changes have taken place in the industry in very recent times. Examples are the liquidation of several insurance companies and the implementation of improved insurance payment procedures to encourage transparency, reduce fraud and provide effective risk coverage (Resolution No. 429/00). However, the industry still presents problems concerning solvency, market structure, operating costs, pricing, regulation and supervision.

2.14 Market conditions in the general insurance industry are adversely affected by the situation of INDER, the former State reinsurance company, as well as by the presence of insolvent insurers. Life, annuities and workers' compensation insurance has evolved more recently and has not been affected by the INDER problem. The resolution of INDER and preventing unsound insurance companies from continuing to issue new policies, are important steps to foster a healthier and more competitive environment for the industry and enable it to play an important role in the economy.

2.15 Concerning the resolution of INDER, the proposed loan supports the adoption of the legal changes required to settle and liquidate the claims of operating domestic companies against INDER ***(first tranche)***. In December 2000, the Government issued a Presidential Decree No. 1220/2000 offering insurance companies three options to settle claims against INDER The Decree was followed by a Superintendent's Resolution in February 2001. The highlights of the Decree and Resolution are:

- **Option 1** - A Company accepts the Government's methodology (sight unseen) for evaluating the claim and receives a 20% up-front cash payment. The methodology is being developed and will consist of an audit process with detailed rules for establishing the value of a claim. The company will have 5 years to amortize the INDER receivable on its books.

- **Option 2** - A Company reserves the right to dispute the Government's methodology for evaluating the claim and has 10 days to dispute it. No up-front payment is received. The company will have 5 years to amortize the INDER receivable on its books.

- **Option 3** – A Company accepts neither Option but is then required to revert to the claim value established in 1997[3] which would then go to the judiciary. Companies would be required to record in their accounts the INDER receivable as per the 1997 value. Option 3 claims must be completed by December 29, 2001. This means that these companies will no longer be able to inflate their assets and capital position by overstating the value of the INDER receivable. This is clearly the worst option for the companies and it is believed that few will choose it.

2.16 The Superintendent's Resolution provides the guidelines to promptly implement this plan. Those accepting Option 1 will receive the 20% cash payment by the end of July 2001. They will thereafter receive 10 semi-annual payments from *Banco de la Nación Argentin*a beginning on October 15, 2001 and continuing through April 15, 2005. By ***second tranche,*** the Government will have settled 100% of the claims against INDER of companies choosing Option 1 and will have paid in cash at least 28% of the total settled sum. The Ministry of Economy and the SSN will be responsible for executing the settlement of INDER claims. The capacity of both is adequate to undertake this work particularly as the Technical Cooperation Loan is providing staff for the Ministry and considerable resources for the SSN (Annex III paras. 1.2 and 1.7).

2.17 In parallel, concerning the need to identify companies not meeting minimum capital requirements and the implementation of measures to address this problem with partial financing provided by the Technical Cooperation Loan described in Annex III, the Program would support implementation of a comprehensive on-site financial review to assess the actual net worth of general insurance companies presently operating. The review would include a process of estimating the liability for outstanding claims (i.e. claims reserves), the collectibility of accounts receivable, the market value of investments, and the quantification of any other important financial deficiencies. By ***first tranche*** disbursement, agreement will have been reached on the methodology for the on-site financial review, the review of at least one company will have been completed and the company will have

[3] In 1997 in an effort to definitively solve the INDER problem, the Ministry of Economy issued Resolution No. 777/97 which contained terms for settlement. The Resolution was unclear on many issues and the industry disagreed with the values proposed with the result that it was not fully implemented.

been classified into one of the following categories: (1) companies having net worth which meets or exceeds the minimum prescribed level, (2) companies having net worth greater than zero but less than the minimum prescribed by law, and (3) companies having net worth of zero or less. For companies falling into category (2), the current norm giving a 4 month period for adjustment will remain in force and they will have to present the required plan for compliance to the SSN ***(second tranche)***. Also by the ***second tranche***, on-site reviews of at least 25 property and casualty companies will have been completed using the above methodology. All companies falling into category (3) would be prevented from continuing to issue new policies or renewing existing insurance coverage ***(second tranche)***.

2.18 The Superintendency of Insurance (SSN – *Superintendencia de Seguros de la Nación*) is not adequately supervising the industry. It lacks: (i) effective supervisory systems, including those to monitor companies' balance sheets and corporate governance; (ii) adequate actuarial tables; (iii) power of enforcement; and (iv) consumer protection schemes. Another basic problem lies in the fact that insurance supervision does not focus on risk assessment and management. This has become even more necessary as the industry segment providing life/retirement insurance has grown rapidly over the last few years. Risk-based techniques would provide benefits in terms of making supervisory actions more consistent and transparent to insurers. The Superintendency does not have the financial and operational information required to reasonably assess the financial health of insurance providers and effectively oversee their solvency and fair practices.

2.19 Aware of these problems, and in addition to the fact that the SSN has been removing insolvent insurers from the market place, the Government has initiated a program to identify financial and operating benchmarks within which the Argentine insurance industry would be able to play a more dynamic role in the process of savings mobilization and investments. Most importantly, a self-assessment of the framework vis-à-vis the standards and principles of the International Association of Insurance Supervisors (IAIS) is being prepared to identify weaknesses in such framework as a requirement for the Financial Sector Assessment Program (FSAP). Completion and presentation to the Bank of such self-assessment is a ***first tranche*** condition.

2.20 As part of the preparatory work for the Program and to improve insurance supervision the Bank has financed studies. through the *Facilidad para Preparación y Ejecución de Proyectos (FAPEP)* Loan 1316/OC-AR. The studies assess the means to move toward risk-based supervision, exploring elements such as incorporating benchmarks and warning ratios including capital, asset quality, reinsurance, adequacy of claim reserve, management, earnings, liquidity and subsidiary and connected companies (CARAMELS). The insurance studies will introduce a Supervisory Ladder which includes appropriate supervisory responses to deficiencies and present a solution to implement the Early Warning System developed under a prior Bank operation (Loan 1163/OC-AR). The studies will

also review the insurance legal framework and propose necessary changes. The harmonization of regulation of insurance and pension products will be explored, as well as, ways to strengthen supervision of newer types of companies (life and retirement/annuity insurance). This work will help to overcome the deficiencies identified above and to improve supervision systems.

2.21 The Supervisory Ladder is a matrix which for each insurance company identifies several levels of company risk across a number of different risk assessment categories, such as on-site inspections, financial analysis, reinsurance, capital adequacy and market intelligence. The level of risk could range from 1 to 4, where 1 represents low risk and 4 represents extremely high risk and would be reserved for companies which are virtually insolvent. The final element to the Supervisory Ladder is the response of the supervisor to each risk assessment category and level of risk. The Supervisory Ladder enables the government to consider the proposed supervisory responses attached to the different risk levels prior to an actual situation of financial distress. A ***second tranche*** condition of this Financial Services Sector Program Loan will be to begin implementation on an action plan for convergence toward international standards of supervision with at least the adoption of the Supervisory Ladder already completed.

4. Capital markets

2.22 Independent of macroeconomic and structural problems affecting companies' competitiveness, and the crowding out effect of increased public debt in private markets, development of Argentina's capital markets is being hampered by four major factors:

(i) a lack of market competitiveness resulting from an obsolete and fragmented market structure that has impeded evolution along the lines observed in developed capital markets;

(ii) deficiencies in the legal, regulatory and supervisory framework;

(iii) limited market issues due to lack of transparency on financial and operating conditions of corporations, resulting in essence from weak accounting and auditing standards and practices and non-adherence to international principles of corporate governance;

(iv) weak demand for securities due to poor economic conditions, savings patterns and tax treatment.

2.23 To date there has not been an integrated approach to the reform of Argentina's capital markets that would facilitate savings mobilization and investment. The Government's strategy (under this Program) is focused on the problems described in (i) and (ii). A second (follow-up) stage would focus on the supply and demand problems described in (iii) and (iv).

2.24 To be effective, Argentina's capital markets reform must be built upon a commitment with the private sector to avoid a "top- down" reform with no real

market impact. To this purpose, the Government has launched a process aimed at engaging the main actors in the private sector through a Capital Markets Development Committee, which is expected to be formalized in the next few months. This Committee would serve as the main forum for discussing the development of capital markets and for analyzing and exchanging ideas. MAE and MERVAL have hired a major international consulting firm to prepare a diagnostic of Argentina's capital markets. The Committee's first task will be to analyze this diagnostic and make recommendations thus allowing the public sector to develop a clearer understanding of the private sector's needs. The natural follow-up based on private sector commitment to support government's efforts would be an engagement to increase the value added of capital markets.

2.25 With this in mind, the Government is moving forward with actions to address other weaknesses. For instance, the capital markets regulator will undertake a self-assessment of compliance with the supervisory practices and procedures established by the International Organization of Securities Commissioners (IOSCO). The proposed Program would support the completion of the self-assessment (***first tranche***). Also, the Government is undertaking studies aimed at making concrete proposals on taxation as it affects capital markets. These studies are being supported by the Technical Cooperation Loan. Finally, the Government, with support from the Multisector Preinvestment II Loan 925/OC-AR, has undertaken studies aimed at making concrete proposals on transparency and corporate governance principles for publicly-traded companies consistent with OECD international standards. As a ***first tranche*** condition, the Government will put into effect the legal framework for these standards which will be satisfactory to the Bank. For the ***second tranche***, the framework remains in force and key regulations are in place.

2.26 The Technical Cooperation Loan will support a review of the results of the self-assessment of compliance with the IOSCO supervisory practices and procedures and the private sector diagnostic financed by MAE and MERVAL. It will provide an analysis of findings and preparation of an action plan to assess the role of the public sector. It will also finance consulting services to support the preparation of the Capital Markets Policy Document . This letter, the content of which will have to be satisfactory to the Bank, will set forth the salient features of its capital markets development strategy ***(second tranche)***. It will cover at least the following areas: capabilities of the Securities Regulator, requirements for issues in primary markets, structure and governance of secondary market institutions, clearing and settlement structure and guarantee systems, entry requirements for intermediaries in different markets, prudential risk management requirements for intermediaries and market institutions, standards for internal organization and operational conduct of intermediaries and market institutions, and tax treatment among different financial instruments and services.

2.27 The Policy Document would follow the guidelines below:

(i) reach consistency with IOSCO Principles;

(ii) provide a clear commitment to consolidate existing market institutions so they are more flexible and competitive in the secondary markets;

(iii) foster the adoption of corporate governance standards by market institutions;

(iv) promote a solid and competitive clearinghouse with a guarantee system which allows clearing and settlement of any kind of public offering issues as well as standard financial derivatives;

(v) promote criteria and profiles of market members which will enable intermediaries of different sizes and importance to be included in the market;

(vi) foster a system that permits members to act in the market from different geographic locations, representing a first step toward integration with other markets; and

(vii) promote market trading principles for listed companies to improve liquidity if legally feasible.

5. Technical cooperation in support of the Program

2.28 The Technical Cooperation Loan to be presented to the Board jointly with the Financial Services Sector Loan would finance a series of activities to support implementation of the Program, as well as studies and consulting services to help in the identification and design of measures (action plans) required to deepen the process. It would thus provide the bases for the second stage of reforms that would support continuation of the dialogue between the government and the Bank in the sector. The corresponding Plan of Operations is presented as Annex III.

C. Cost and financing

2.29 The amount of Bank financing under the proposed Program would be US$500 million to be disbursed in two equal tranches. The first would be released upon effectiveness (around June/ July, 2001). The second is estimated to disburse about six months later. Both disbursements would follow government's completion of the conditions outlined in the attached preliminary Policy Matrix (Annex I). The total loan amount is being dimensioned in accordance with the adjustment efforts implied by the reform package supported by the Program and the financing requirements of the Government for the period 2001-2002.

2.30 Based on recent information, the financial flows required for 2001 alone could reach US$17.5 billion, of which, the Government has already raised US$12.3 billion. The Government intends to raise the remaining US$5.2 billion through foreign bond placements, privatization, and loans from multilateral organizations, including US$1.3 billion from the IDB and the World Bank.

III. PROGRAM EXECUTION

A. Borrower and executing agency

3.1 The Borrower of the loan will be the Government of Argentina and the Executing Agency will be the Ministry of Economy through the Secretary of Finance. The Secretary of Finance will be responsible for: (i) supervision of Program implementation activities; (ii) presentation to the Bank of the documents required for compliance with the conditions for disbursements; (iii) ensuring proper coordination between the unit directly in charge of monitoring and execution (*Unidad Ejecutora del Proyecto* - UEP) and the superintendencies of insurance (SSN), securities (CNV) and pension funds (SAFJPs); and (iv) providing timely and sufficient budgetary resources to carry out the studies, action plans and preparation of documents and proposals required in the agreed conditions for disbursements.

B. Program execution and administration

3.2 The Secretary of Finance will take the necessary legal and administrative actions required to formally establish the UEP, which should be fully functioning before the first disbursement. The UEP will be comprised of a general coordinator, a technical coordinator, two consultants, an administrative officer and accountant, project assistant and two administrative assistants. The general coordinator and the technical coordinator will be appointed by the Secretary of Finance for a term of at least one year. The UEP is being financed by a credit line of the Multisector Preinvestment Loan 925-OC-AR approved in September 2000, and MAPPE AR-0283 approved in March 2001

3.3 In addition to its overall role of ensuring the quality of the studies to be executed and retaining the necessary consultant expertise, UEP will: (i) obtain from the corresponding government agencies the documents, reports, and other information supporting compliance with the disbursement conditions for the first and second tranches; (ii) coordinate and monitor the activities of the Superintendencies that have to be carried out as part of the Program; (iii) develop terms of reference, hire consultants and administrate and supervise execution of the studies; (iv) represent the Secretary of Finance vis-a-vis the Bank regarding all technical aspects of the Program; and (v) prepare the agreed periodic reports to the Bank and other reports and information for the Bank administration missions.

3.4 In order to achieve a smooth interface in the coordination of activities between the UEP and the Superintendencies, a task force has been established which is comprised of the UEP and three senior officers appointed by CNV, SSN, and SAFJP. This task force will prepare an execution plan and timetable for the activities to be financed with Bank resources. The task force will hold monthly meetings to review progress in the execution, update information, and prepare brief reports for the Secretary of Finance and the Superintendencies. The

Superintendencies, through their representatives in the coordinating task force, will provide UEP with technical support for the preparation of terms of reference for the studies and action plans required to execute the Program.

C. Procurement

3.5 The fast-disbursing funds from the sector loan may be used to finance the aggregated cost in foreign exchange of eligible imports from the Bank's member countries. In this case, the Bank's procedures for sector loans, which do not require international competitive bidding, will be applied. The funds would be disbursed when requested by the borrower and evidence is presented that all the contractual conditions have been complied with.

D. Execution and disbursement period

3.6 The period for executing the Financial Services Sector Program will be up to 12 months. The amount of financing will be disbursed in two tranches. The first tranche in the amount of US$250 million will be available upon submission of evidence satisfactory to the Bank that the conditions for the first tranche conditions in Chapter II have been achieved. The second tranche in the amount of US$250 million will be available upon compliance with the second tranche conditions listed in Chapter II. The Government will open an exclusive account to receive the sector loan funds.

E. External auditing

3.7 The Bank reserves the right to request financial reports from the Borrower on the use of the resources of the loan proceeds, audited by independent auditors previously accepted by the Bank.

F. Conditions for disbursements

3.8 First tranche disbursements are conditioned upon: (i) maintenance of a macroeconomic program that is consistent with a stable environment for execution and implementation of the Financial Services Sector Program and the IMF Program; (ii) compliance with the policy actions for the first tranche disbursement specified in Chapter II and Annex II; (iii) opening of a special account for management of the loan proceeds; and (iv) establishing the UEP. Second tranche disbursements are conditioned upon: (i) continued maintenance of a macroeconomic program that is consistent with the objectives of the IMF Program; and (ii) compliance with the policy actions for the second tranche disbursement specified in Chapter II and Annex II.

G. Monitoring and evaluation

3.9 Ninety days after Loan Agreement signature, and one month before the date of the expected disbursement of the second tranche, the Ministry of the Economy

through the UEP, will present to the Bank reports on the activities being carried out to meet the conditions for disbursement. It shall continue to submit these reports every three months until completion of the execution of the Program. These reports should describe the progress being made regarding each condition for disbursement, include a plan of activities for the next reporting period and highlight future reform areas to be addressed.

3.10 The Bank project team will evaluate the information and reports presented to it on compliance with the conditions, and will prepare reports for the Board of Executive Directors in accordance with Bank policy.

H. Inspection and supervision

3.11 The Bank will establish the inspection procedures necessary to ensure satisfactory execution of the Program. The borrower will fully cooperate with the inspection requirements and will provide assistance and information to facilitate this task.

I. Government Policy Letter

3.12 The Bank agrees with the Government macroeconomic and sectoral policies contained in the Policy Letter attached as Annex II. This Letter outlines the major elements of the strategy and policies that are being implemented in the financial services areas included in the Program and the Government's commitment to undertake the reforms and actions agreed with the Bank.

IV. VIABILITY, RISKS AND BENEFITS

A. Viability and risks

4.1 Successful implementation of the Program requires active participation and coordination of efforts between the Superintendencies, the tax policy department, and the Program Executing Unit (UEP) under the overall guidance of the Ministry of Economy. The Superintendencies, the tax authorities and their staff have already shown their cooperation and support for the reforms during the preparation stage of the Program. In addition, a significant amount of coordination, exchanges of views and sharing of information is already underway between the Superintendencies and the UEP coordinating the preparation of the program.

4.2 The Program also requires adequate staffing to monitor the sector loan and the reforms and to execute the studies which support insurance strengthening, capital markets policy and other matters. For this reason, the Bank is providing the Technical Cooperation Loan described in Annex III to finance the UEP. The UEP will provide for definition of responsibilities, periodic reports, and timely monitoring of activities of the various agencies, units, and officials involved with

the purpose of ensuring implementation of the agreed measures. In addition, the execution of the Program and implementation of the actions to be agreed will be supported thorough analytical work and action plans developed with the assistance of a carefully selected team of experts on the various program components that will be funded with Bank technical cooperation resources. This should help to reduce this risk.

4.3 Another risk is associated with the technical capacity to design and implement the reforms associated with the Program. The Technical Cooperation Loan provides extensive support to the executing agency in terms of staffing and expert consultants most notably in the areas of insurance supervision and regulation and capital markets as described in Annex III.

4.4 The success of the Program also depends on the degree of support that the proposed reforms may generate among private sector companies and individuals that operate in the insurance, pension, and capital markets. In order to deal with the risks associated with this issue, a special consensus-building effort is being made by the UEP and the Superintendencies to engage and bring forward the contributions that interested parties of the private sector may make during the development of the new regulations and operating procedures. In addition to the events described in paragraph 3.4, the UEP and Superintendencies are planning a series of seminars and conferences to build consensus and exchange views with the private sector in order to gather political support for the reforms and legislative changes. The risks of executing and implementing the Program will be mitigated by the arrangements made for coordination, assignments of responsibilities and technical support mentioned above.

4.5 The attainment of the Program objectives is also contingent upon the successful implementation of a stable macroeconomic framework. The Government is committed to this goal and is pursuing a program with the IMF which includes macroeconomic measures including redressing the fiscal imbalance as described in Section A of Chapter I. At the moment, the macroeconomic situation is extremely difficult. However, the Government's commitment to improve the macroeconomic framework and its willingness to take the necessary measures, enhance the likelihood that it will be successful.

4.6 Finally, there is the risk that it will be politically difficult to undertake the reforms that are envisaged under the program. While the Government has experienced opposition to reforms, particularly in the face of the poor economic situation, it has been able to move at an accelerated pace to issue decrees on such thorny matters as changing the regulatory and supervisory framework of financial services and solving long-pending matters such as the situation of INDER. The political will of the government to institute these reforms appears unwavering. Although it has been difficult to build political consensus, thus far the record has been good and there is no reason to believe that it would deteriorate or be unsuccessful.

B. Environmental and social impacts

4.7 The Environmental and Social Committee reviewed the Profile II of the Program on March 30 of 2001, and concluded that given the nature of this Program and the type of measures comprising the policy package, there is no need for mitigating actions since it is envisaged that the Program will not have direct environmental or social impacts.

C. Benefits

4.8 The policy measures supported by this Program are expected to make a significant contribution to improve competition among providers of financial services, which in turn should benefit consumers and investors through the availability of a wider choice of pension fund options, insurance products, and other saving and investment instruments. Enhanced competition should also lead to higher quality of financial services priced more efficiently.

4.9 The property rights of consumers and investors would be better protected through the requirements contained in this Program that financial services providers disclose more complete information on pension plans and on insurance products marketed. Minority shareholders would also benefit from having access to more transparent financial statements and enhanced rules of corporate governance.

4.10 The measures included in this Program would also possibly help to expand the fraction of the work force covered by retirement plans, the number of people protected by insurance policies, and the volume of transactions in the security markets. The expansion of these markets would generate value-added in the financial sector and contribute to raise employment.

FINANCIAL SERVICES SECTOR PROGRAM (AR-0266)

POLICY MATRIX

Component	First Tranche	Second Tranche
A. Macroeconomic Framework Objective: stable macroeconomic environment for Program execution and implementation	1) The Government is implementing a macro-economic policy program that is consistent with the objectives of the Financial Services Sector Program and the IMF Program.	2) A macroeconomic program consistent with the objectives of the Financial Services Sector Program and the IMF Program.
B. Pension System Reform Objectives: Increase competition, reduce costs of services, and widen choices of investment and saving instruments	3) Prepare and present to the Bank a satisfactory plan to amend the pension system legal framework to: • authorize AFJPs to offer more than one fund to pension plan members; • permit the elimination of the Stabilization Fund and credit funds to members' accounts; • increase flexibility of investment policy by empowering the regulator to change the limits per category of investments up to 10 percentage points in any direction; • increase flexibility in investment in shares; • introduce a commission structure for the AFJPs which is transparent and eliminates fixed fees; and • eliminate the ceiling for lump sum withdrawal upon retirement.	4) The basic legal framework for the pension system is in force and regulations have been issued and are in effect on: • content and design of the information to be regularly provided to affiliates (SAFJP); • the ways that the AFJPs will be ranked monthly based on commissions costs (SAFJP); • making investment policy more flexible including changing percentages and criteria for investing in shares (SAFJP); and • characteristics of the new funds to be offered by the AFJPs to affiliates (Executive Power and SAFJP).
C. Insurance Sector Restructuring Objectives: Promote a competitive and financially sound marketplace, and strengthen regulatory frame-work and capabilities of the Superintendency (SSN) to carry out its responsibilities	5) Introduce changes in the normative framework to settle and liquidate all claims of insurance companies against INDER. 7) Agree with the Bank on the criteria to be used for the on-site comprehensive financial review to assess the actual net worth of general insurance companies and group them into categories and complete the review of at least one company. 9) Present a self-assessment satisfactory to the Bank to evaluate the degree of compliance with IAIS Principles.	6) Settle 100 % of claims against INDER of companies accepting Option 1 and pay in cash at least 28 % of the total settled sum. 8) Complete on-site review of at least 25 property and casualty insurance companies using criteria developed as a first tranche condition. 10) Prevent insurers with zero or negative net worth from issuing new or renewing existing insurance coverage. 11) Maintain norms requiring that undercapitalized companies be given not more than four months for compliance. 12) Present an action plan satisfactory to the Bank for convergence of regulatory framework towards international standards having completed at least the implementation of the Supervisory Ladder. Action plan would include timetable and defined responsibilities.

D. Capital Markets Development Objectives: Strengthen capital markets structure, foster transparency and good governance, provide better protection of minority shareholder rights, and enhance regulatory function.	13) Put into effect the legal framework relative to transparency and corporate governance standards consistent with OECD principles for publicly-traded companies which is satisfactory to the Bank 15) Complete and present a self-assessment satisfactory to the Bank to evaluate the degree of compliance with IOSCO Principles.	14) The legal framework relative to transparency and corporate governance standards consistent with OECD principles for publicly-traded companies is in force. The key regulations are in place. 16) Present and announce to the public a Capital Market Policy Document satisfactory to the Bank including at least the following areas: • Enforcement capabilities of the Securities Regulator; • Requirements for issues in primary markets; • Structure and governance of secondary market institutions; • Clearing and settlement structure and guarantee systems; • entry requirements for intermediaries in different markets; • prudential risk management requirements for intermediaries and market institutions; • standards for internal organization and operational conduct for intermediaries and market institutions; and • tax treatment among different financial instruments and services.

Letter of Financial Sector Policy

BUENOS AIRES, May 15 2001.-

Ref : FINANCIAL SERVICES SECTOR POLICY LETTER .-

Mr. Enrique IGLESIAS
PRESIDENT
INTER-AMERICAN DEVELOPMENT BANK
1300 New York Avenue, NW
Washington, DC

Dear Mr. IGLESIAS:

1. The Government of Argentina is undertaking a wide range of macroeconomic and financial sector reforms which together will help to make the financial services more efficient, competitive and transparent. In this context, the Government of Argentina is requesting financial support from the Inter-American Development Bank (the Bank) to implement the structural reforms described below.

2. The macroeconomic program supported by the IMF aims at deepening the strategy to ensure fiscal viability in the medium term and at promoting a sustainable economic recovery. The new initiatives, reflected in the Law on Competitiveness issued by the end of March 2001, comprises efforts to strengthen fiscal revenues, to target reduction in expenditures and grants special powers to the Executive Branch for a year to reform the public sector, taxation and the regulatory framework.

3. During the 1990s, the Government of Argentina undertook a profound transformation of the country's financial sector that resulted in the creation and rapid development of new institutions, markets, and instruments. This process was accompanied by a significant growth in the volume of transactions and services to businesses and to the general public. The Government of Argentina is currently engaged in a program of second-generation reforms in line with best international practices, directed to further improve the functioning of the securities, insurance and pension fund markets, to create conditions for the delivery of high-quality and cost-efficient services, to harmonize and enhance regulation and supervision, to promote consumer and investor protection, and to facilitate regional integration and competition with and among other regional and international financial markets.

I. Macroeconomic Framework

4. The Government that took office in December of 1999 launched a set of programs aimed at fiscal consolidation and wide-ranging structural reforms to increase the competitiveness of the economy, to facilitate growth of economic activity and employment, and to reduce the fiscal deficit in the short run. Based on these objectives, it signed a Letter of Intent with the IMF in February 2000.

5. In early November of 2000, the Government announced a set of measures designed to reduce the public sector deficit and restore investors' confidence. These measures included reform of the public pension regime, an agreement with the provinces to control provincial deficits strengthening tax administration, rationalizing public spending, making social security and health systems more equitable and efficient, modernizing labor legislation, promoting job creation and strengthening the domestic financial system. These measures provided the bases for a new program with the IMF, which was approved in January 2001. The stand-by program amounted to US$13.7 billion, to be supplemented with additional resources of about of US$26 billion from multilateral and bilateral lenders, and local banks and private pension funds. It is in this context that the proposed Financial Services Sector Program has been developed.

6. A central aspect of the policy package is the strategy to reduce fiscal deficits at all levels of the public sector with the purpose of effecting a sustained lowering of the public sector debt in relation to GDP over the medium term. The Government budget for 2001 envisages a modest reduction of the deficit but the Government is committed to revising the fiscal responsibility law to achieve a decline of the deficit in subsequent years leading to a zero deficit by 2005. A similar commitment was agreed with respect to the Provincial Government deficits in the recent federal fiscal pact. In May 2001, a new Letter of Intent with the IMF was signed establishing new limits on national and subnational expenditures and deficit and presenting structural measures to promote competition and to facilitate a better allocation of resources in the economy.

7. The international financial package and the implementation of the policy package are expected to bolster investor confidence and contribute to restoring economic growth and employment. GDP growth is projected to reach 2.5% this year. Over the medium term, GDP growth is expected to be sustained at around 4%. Inflation is expected to remain lower than in major trading partners, thus helping competitiveness. The external trade balance is projected to increase in 2001 supported by a sustained growth of exports. As a result, the current account deficit is expected to decline slightly, partly offset by higher net interest payments abroad.

8. The proposed Program would support implementation of a macroeconomic policy program that is consistent with a stable environment for execution and implementation of the proposed operation.

II. Financial Services Reform

9. The economic strategy launched in the early 1990s had a profound and positive impact on the development of the financial services sector. By the end of the decade the size and scope of the

money, credit, equities, bonds, and annuities markets had increased at a rapid pace and reached significant levels. The volume of transactions in the insurance industry, new pension funds, and several other participants in these markets multiplied. Following international standards and practices, the respective regulatory agencies have been revisiting and strengthening their functions and enforcement capabilities, improving the technical capacity of their personnel, and updating the norms governing the activities of larger and more complex players.

10. Nonetheless, and despite the significant progress already made, a number of issues remain to be addressed. First, the differences between bank and non-bank financial services have been minimized over the last few years, which calls for an integrated approach to financial services. At present, the banking system is noticeably more developed than non-bank financial institutions, both in terms of volume of resources but also of regulatory capacity. In order to promote a more balanced financial development and to remove perverse regulatory arbitrages and gaps, the specific focus of the reform is the private pension, insurance, and securities markets.

11. A number of issues have already been identified as impeding the expansion of non-bank financial services. These issues pertain, for example, to regulatory and supervisory deficiencies, insufficient transparency, competition and consumers′ and investors′ protection, and tax asymmetries. As an essential part of the reform program to deal with these problems, convergence to international standards and practices must also be encouraged.

12. As a consequence of the overwhelming weight of the banking system in Argentina until the early 1990s, not enough effort has been devoted to the study of other financial intermediaries. Accordingly, the integrated approach to financial services creates a demand for policy-oriented studies on the pension, insurance, and securities markets, and their links to the banking system, aimed at identifying weaknesses and at proposing viable solutions. Such studies will be used as a central input for the implementation of the reform program.

A. Private Pension System Reform

13. The Government has decided to deepen the reform program begun during the last decade and to promote new reforms through a Presidential Decree issued on December 2000. Despite the gains achieved by the pension system since the reform of 1994, over the last few years the system has developed some weaknesses that require continued reforms. These are: (i) inefficiency and inadequate competition; (ii) inadequate protection of members' property rights and their ability to manage risk; (iii) inflexible investment regulations; and (iv) underdeveloped voluntary contractual savings systems. While the Government of Argentina is addressing pension issues from both the private and public pension systems, the focus of this operation with the Bank is on strengthening aspects of the private pension.

14. The pension system's operating costs are high relative to comparable countries for several reasons. Benefit payments under the mandatory pillar require that AFJPs obtain certification of benefits from ANSES, consuming considerable resources and time. Competition among AFJPs

is hampered by insufficient disclosure of information on commissions and rates of return, and by the allocation of undecided members among AFJPs on a *pro rata* basis rather than according to performance criteria.

15. Concerning the regulatory framework for investments, and the issues of risk management: (i) the Stabilization Fund, which sets aside as reserves AFJPs' returns in excess of the system's average plus 30%, restricts management of investments and creates a pool of funds away from contributors' ownership; (ii) investment instruments and portfolio composition limit both the AFJPs' and the affiliates' ability to manage portfolios and risks. AFJPs can only offer one fund option to members and thus all members have the same portfolio composition irrespective of their risk preferences; (iii) limits on AFJPs' investment allocations are capped by law; (iv) investment in equity requires ratings, and since rating of shares is not an international practice, the requirement impairs investment in foreign shares, which is limited to 7% of the portfolio.

16. Voluntary contractual saving schemes are still quite underdeveloped in Argentina. Although AFJPs can take voluntary contributions for retirement with the same favorable tax treatment as mandated contributions, they have been unable to mobilize them. One reason is the relative lack of liquidity of these savings until the time of retirement. Other is the fact that even at the time of retirement there is a limit for withdrawals of these funds as a lump sum.

17. These deficiencies have been addressed through the above mentioned Presidential Decree as follows by: (a) simplifying and accelerating benefit and disability certification; (b) eliminating flat fees from the commission structure; (c) requiring that the quarterly reports provided to active affiliates include more transparent information on the fund's and system's performance; (d) allocating undecided workers to AFJPs with the lowest cost and the best ability to provide adequate service to members therein promoting competition; (e) improving risk management by eliminating the Stabilization Fund and crediting funds to members' accounts, increasing flexibility of investment policy, and authorizing AFJPs to offer more than one fund ; and (f) removing the ceiling for lump sum withdrawals upon retirement. Additional regulations will be issued to complete the implementation of such measures.

18. The application of the Decree has recently been temporarily suspended by a judicial decision until a formal Court ruling takes place. However, the Government is committed to implement the necessary changes in the private pension system in 2001.

B. Insurance Industry

19. Significant changes have taken place in the industry in the recent past. Relevant examples are the liquidation of several insurance companies and the implementation of improved insurance payment procedures to encourage transparency, reduce fraud and provide effective risk coverage. However, the industry still presents problems concerning market structure, operating costs, pricing, and regulation and supervision.

20. Market conditions in the general insurance industry are adversely affected by the situation of INDER, the former State Reinsurance Company, and the weakness of some insurers. Life, annuities and workers' compensation insurance has evolved more recently and has not been affected by the INDER problem. The resolution of INDER claims and the reorganization of the market through mergers, acquisitions, and equity increases are important steps to foster a healthier and more competitive environment for the industry to play an important role in the economy.

21. On December 2000, the Government issued a Decree offering insurance companies three options to settle claims against INDER. Under the proposed Program the Government is committed to liquidate/settle the claims of companies against INDER which select the first option offered, consisting of a down payment of 20% of the claim and semi-annual payments over a 5-year period.

22. Simultaneously, the Government is launching a comprehensive financial review to assess the actual net worth of all insurers presently operating, identify companies that do not meet minimum capital requirements, and implement measures to address this problem. The review, which will be carried out for a representative number of property and casualty insurance companies by year end, will include a process of estimating the liability for outstanding claims (i.e. claims reserves), the collectibility of accounts receivable, and the market value of investments.

23. Based on this assessment, insurers will be grouped into three categories: (1) companies that meet the capital requirements ; (2) companies that do not meet the capital requirements; and (3) companies that have negative net worth. It is the Government's intention to prevent those in category (3) from continuing to issue insurance coverage and for the SSN to initiate liquidation procedures of those companies, and to bring those in group (2) into compliance with minimum capital requirements.

24. Another fundamental problem is that insurance supervision does not focus on risk assumption and management. This has become even more necessary as the industry segment providing life/retirement insurance has grown rapidly over the last few years. Risk-based techniques would provide benefits in terms of making supervisory actions more effective and also more consistent and transparent to insurers.

25. In this context, the Government has initiated a program to identify financial and operating benchmarks within which the insurance industry in Argentina would be able to play a more dynamic role as a provider of financial services. In particular, a self-assessment of the regulatory framework vis-à-vis the standards and principles of the International Association of Insurance Supervisors (IAIS) has been prepared to identify weaknesses in such framework. This self-assessment will provide the basis for designing required regulatory changes. Among these will be, the adoption of a series of risk assessment benchmarks for insurers along with a range of potential supervisory responses associated with each level of risk. The Program will support the implementation of a plan for convergence towards international standards, particularly of risk assessment.

C. Capital Markets

26.The Government is seeking to address four key weaknesses which would help capital markets play a more relevant role in the saving mobilization process and the diversification of risks. The first pertains to the fragmented structure of the market which greatly hampers its competitiveness. The second is the need to improve the regulatory and supervisory framework. The third is the need to make corporate issuers' financial reports more transparent and encourage adherence to international principles of corporate governance. The fourth is the tax treatment of investment instruments which results in weak demand for capital market products.

27.The private sector has already come to realize that there are a number of problems with the capital markets in Argentina. The Government assigns a high priority to working closely with the private sector, whose suggestions will be used as an input for the Capital Markets Strategy to be released by year end.

28.The Government is strengthening the regulatory framework. The Securities Commission (CNV) has conducted a self-assessment of compliance with the international practices and procedures established by the International Organization of Securities Commissions (IOSCO). The results from this self-assessment will be also incorporated in the Capital Markets Strategy.

29.The move towards international principles of corporate governance, stressing transparency and protection of minority shareholders, is also of paramount importance. The Government is preparing a Delegated Decree on "Transparency in the Public Offering Process" which reflects international standards.

30.In sum, Argentina has made progress in addressing financial sector issues during the reforms of the 1990s and has an ambitious program for continuing them in the twenty-first century. As described in this Letter, the Government is strongly committed to make financial services more efficient and competitive, to improve transparency and to better protect consumers and investors, by supporting reforms in the legal, regulatory and supervisory frameworks. The policies to be implemented over the next year will strengthen these areas. The Government of Argentina expects that this Financial Services Sector Program will be approved, and looks forward to working with the Bank to ensure its successful implementation.

Sincerely yours,

Domingo F. CAVALLO
MINISTER OF THE ECONOMY

PLAN OF OPERATIONS

TECHNICAL COOPERATION LOAN IN SUPPORT OF THE FINANCIAL SERVICES SECTOR PROGRAM

(AR-0284)

EXECUTIVE SUMMARY

Borrower:	Government of Argentina		
Executing agency:	Ministry of Economy, Secretary of Finance		
Amount and source:	IDB: (OC)	US$	2,000,000
	Cofinancing:	US$	0
	Local counterpart	US$	200,000
	Total:	US$	2,200,000
Financial terms and conditions:	Amortization Period:	20	Years
	Grace Period:	15	Months
	Interest Rate:	variable	
	Supervision and Inspection:	1	%
	Commitment Fee:	0.75	%
	Currency:	US Dollars from the single currency facility	
Terms:	Execution Period:	12	Months
	Disbursement Period:	15	Months

Objectives: The purpose of the Technical Cooperation (TC) is to support the Government of Argentina in its reform of financial services, complementing the Bank's Financial Services Sector Program.

Description: The TC will be concentrated in two areas: (i) the operations of the project implementation unit (*Unidad Ejecutora del Programa* – UEP) of the Financial Services Sector Program Loan; and (ii) studies in the areas of insurance, capital markets, regulation and supervision of conglomerates, taxation of financial service industry, international accounting standards and financial risk management using international codes and standards.

Environmental/ social review:	Given the nature of the technical cooperation, the CESI Committee determined that it would not have any direct environmental or social impact in its meeting of March 30, 2001.
Benefits:	The TC will support the Government in achieving the Sector Loan objectives to: (i) promote a competitive and financially sound market place; (ii) foster the delivery of high-quality and cost-efficient financial services to individual consumers and enterprises; (iii) improve governance of institutions and corporations; and (iv) strengthen and bring up to international standards the regulatory functions and enforcement capabilities of regulators.
Viability and risks:	The principal risk for successfully implementing the TC arises from the need for active participation and coordination of efforts between various regulatory agencies and the Program Executing Unit (UEP). The risks will be mitigated by the attention provided to coordination, assignments of responsibilities and technical support. A special consensus-building effort has been launched by the Superintendencies to engage the private sector and better insure their views are reflected in the studies which should further mitigate risk.
Special contractual conditions:	Establishment of executing entity (UEP) with staff and criteria described in para. 2.2.
Exceptions to Bank policy:	Two exceptions to Bank policy are sought for retaining the Coordinator General of the UEP. The first is with regard to the Bank's competitive bidding procedures as the Coordinator General was hired in mid-2000 by the Government. The second exception sought relates to a possible conflict of interest as the Coordinator General assisted in preparing this TC proposal. The Government wishes this person to continue as Coordinator General because of her excellent professional profile and for reasons of Program continuity. The remaining staff of the UEP were hired under the Bank Pre-investment Loan (925/OC-AR) or shall be contracted following the Bank's procedures.

I. Program Objectives And Execution

A. Objectives and description

1.1 The purpose of the technical cooperation (TC) is to support the reforms that the Government of Argentina will undertake as part of the Financial Services Sector Program Loan (the sector loan).

1.2 The TC will be concentrated in two areas: (i) the operations of the Project implementation unit (*Unidad Ejecutora del Proyecto,* UEP) of the sector loan; and (ii) studies in the areas of insurance, capital markets, regulation and supervision of conglomerates, taxation of the financial service industry, international accounting standards and international codes and standards for risk management of financial services. The studies will consider regional integration issues of insurance and capital markets will reflect findings and results of the studies on regulation of conglomerates, taxities, accounting and risk management .

1.3 It is worth noting that the operations of the UEP and the elaboration of the studies during the preparation stage were financed by a credit line of the Multisector Preinvestment II Loan 925/OC-AR and the *Facilidad para Preparación y Ejecución de Proyectos (FAPEP)* Loan 1316/OC-AR. The Multisector Preinvestment II Loan financed: (i) a review of tax asymmetries in the financial service sector; (ii) the development of a best practice, corporate governance law; and (iii) an analysis of the international experience of the financial services supervision and alternatives to consolidated financial supervision. The FAPEP facility financed reviews and analyses of: (i) the emerging financial conglomerates, their structure and potential shortcomings in regulation; (ii) the insurance sector and how to achieve risk-based regulation; (iii) the private pension system and ways to increase competition and efficiency; and (iv) the financial regulatory agencies in Argentina, shortcomings and ways to strengthen regulation and supervision.

B. Description of the components

1. Support for the operational capacity of the UEP

1.4 The UEP has several responsibilities including: supervising the completion of the studies, guaranteeing the coordination of the superintendencies of pension, insurance and capital markets during execution and overseeing the implementation of the conditions associated with the sector loan. The FAPEP facility provides funding for the UEP until the TC Loan becomes effective. At that time, the TC Loan will assume the financing of the UEP and the FAPEP funds will be recovered from it.

2. Studies

a) Insurance sector

1.5 The objective of the insurance studies is to assist the Government of Argentina in support of the implementation of the conditionalities of the sector loan. Additionally, the studies focus on the development of insurance in Argentina with a view toward making the market financially sound and more transparent, providing consumer protection, and bringing the supervision and regulatory standards up to international norms, such as those of the International Association of Insurance Supervisors (IAIS). Particular emphasis is being given to the interface with MERCOSUR countries and compatibility between local and international accounting standards. The studies to move toward risk based supervision, are being financed by the FAPEP.

1.6 To assist the Government in assessing the financial health of the insurance industry in concert with settling claims under the INDER proposal, the TC loan will support the financing of a comprehensive on-site financial review of companies to assess actual net worth, estimate liabilities for outstanding claims (i.e. claims reserves), collectibility of accounts receivable, and market value of investments, and quantify any other important financial deficiencies. Based on the results of this review, insurance companies would be classified into one of the following categories: (1) companies having net worth which meets or exceeds the minimum prescribed level, (2) companies having net worth greater than zero but less than the minimum prescribed by law, and (3) companies having net worth of zero or less. By second tranche of the sector loan, and as a condition for it, at least 25 property and casualty companies will have been reviewed and an on-site visit conducted with support from the TC Loan. All companies falling into category (3) would be prevented from continuing to issue new policies and to renew existing insurance policies.

b) Capital markets

1.7 The TC for capital markets attempts to assist in forging the link between the private and public sector initiatives to broaden and deepen capital markets and therein support the sector loan. The MAE and MERVAL, privately-owned debt and equity markets institutions, have hired a major international consulting firm to prepare a diagnostic and an action plan of the Argentina capital markets. The results of this diagnostic financed by the private sector are expected by mid-2001. The TC will provide the Ministry of Economy with technical expertise to analyze, review and comment on this work.

1.8 The Government is undertaking a self-assessment of CNV's supervision and regulation to determine *inter alia* how closely it complies with IOSCO principles.

The self-assessment is being undertaken as an event of the FSAP with the IMF and World Bank. The Government has agreed to make the self-assessment available to the Bank.

1.9 The TC will undertake any additional analysis to complement the private sector diagnostic the IOSCO-based self-assessment as needed, and provide a basis for the preparation of the Capital Market Policy Letter. Presentation of this letter, satisfactory to the Bank, is a second tranche condition of the sector loan.

1.10 The TC will also support the Government's desire to move closer to international principles of corporate governance. The Bank financed the development of preliminary legal work on the transparency and corporate governance under Loan 925/OC-AR. Through the TC it is proposed to finalize the work on transparency and corporate governance standards consistent with OECD principles for publicly-traded companies. Issuing the norm amending the legal framework relative to transparency and corporate governance is a condition of the sector loan.

c) Harmonization of regulation and supervision of financial conglomerates

1.11 FAPEP Loan 1316/OC-AR financed an assessment of the composition, activities and regulation of financial conglomerates which are new players on the Argentine financial scene. Conglomerates which are comprised of insurance, pension and companies working in capital markets, have been expanding rapidly in Argentina and their regulation has not kept pace with this growth. The TC will extend the assessment, reviewing the harmonization of regulatory criteria and benchmarks to better insure that the conglomerates are adequately supervised. The TC will also recommend appropriate corporate governance principles for the conglomerates.

d) Financial services tax reform

1.12 Loan 925/OC-AR financed an analysis of tax asymmetries in the financial services sector in order to reduce distortions and promote balance. The TC will expand this analysis, preparing a plan which assesses the feasibility of proposed changes in the context of budgetary and legislative constraints. It will identify and rank the most essential changes for balanced development of the sector and prepare the rationale and economic underpinning for changes proposed in the rules and regulations. The aspects of this work associated with capital markets will serve as input into the Capital Markets Policy Letter.

e) **International standards for accounting and auditing**

1.13 Current accounting and auditing norms in Argentina differ from international practices and do not facilitate the ability of publicly-traded companies[1] to finance themselves on the market. To support Argentina in enhancing the ability of companies to access funding and to protect consumers and investors, the TC will finance a review of accounting, auditing and actuarial standards. In particular, it will review the legislative framework with a view toward identifying gaps and overlaps in the law, and differences between the regulatory framework and the principles of IFAC and IASC. A plan to bring local standards and legal framework in line with international principles bearing in mind ways to incorporate the different groups working in these areas, would be the result of this study.

f) **Implementation of international codes and standards**

1.14 Based on the results of the FSAP, the TC will finance the design of preventive measures to cope with potential risks of the Argentine financial services and promote greater market stability. The study will rank the risks found by the FSAP in order of priority and review the different means of diminishing and controlling them, i.e., legislative, rules and regulations, improved regulatory coordination, improved information systems and human resources.

II. PROGRAM EXECUTION

2.1 The Borrower of the loan would be the Government of Argentina and the Executing Agency would be the Ministry of Economy through the Secretary of Finance. The Secretary of Finance will formally establish the Project Executing Unit (*Unidad Ejecutora del Proyecto* UEP).

2.2 The UEP will be comprised of a general coordinator, a technical coordinator, three consultants, administrative officer and an accountant, project assistant and two administrative assistants. The general coordinator and the technical coordinator will be retained by the Secretary of Finance for a term of at least 15 months from the date of the loan.

C. Functions of the executing unit

2.3 The UEP will be the unit directly responsible for executing the TC activities and its main responsibilities will include: (i) representing the Secretary of Finance vis-a-vis the Bank regarding all technical and financial aspects of the TC Program; (ii) coordinating and monitoring the work of the Superintendencies (CNV, SSN

[1] as differentiated from private companies whose shares are not available to the public

and SAFJP) regarding the studies and action plans that have been agreed to be carried out as part of the Financial Services Sector Program and the TC Program; (iii) developing terms of reference, hiring consultants and administering and supervising the execution of the studies funded with the TC resources; (iv) obtaining from the corresponding government agencies and presenting to the Bank, the documents, reports, and information regarding compliancy with the disbursement conditions agreed for the Financial Services Sector Program; (v) preparing periodic reports and other reports and information for the Bank on progress and administration of the TC Program; and (vi) submitting disbursement requests and duly audited financial statements to the Bank.

2.4 The UEP and the Superintendencies, will execute a Memorandum of Understanding (MOU) to facilitate the coordination of activities. The MOU will set forth the responsibilities of the UEP, SAFJP, CNV and SSN. It will appoint representatives from the regulatory agencies to serve as technical counterparts to the UEP and the consultants hired to perform the activities funded by the TC Program. The MOU will also establish a clear commitment of the UEP and the regulatory agencies to work together to fulfil the conditionalities of the Financial Services Sector Program as established in the Policy Matrix.

III. PROGRAM COSTS AND FINANCING

1. Cost of the technical cooperation

3.1 The total cost of the technical cooperation program is US$2,200,000 equivalent from which the Bank's contribution is US$2,000,000 equivalent and the counterpart is US$200,000.

3.2 To support the preparation and implementation of some of the components of this program, the Bank approved FAPEP Loan 1316/OC-AR, in the amount of US$602.000. The FAPEP, and the financial costs related with this facility will be repayable from the first disbursement of this technical cooperation loan. Special items were included in the table of costs, identified as Recovery of FAPEP, in the amount of US$602,000, and Contingencies and Financial Costs related to FAPEP, in the amount of US$25,000.

3.3 Tax expenses associated with items financed through the FAPEP facility are requested to be recognized as part of the counterpart funding. A special row included in the table of costs, identified as recognition of past tax expenses presents this request.

Component	Local	IDB	TOTAL
1. Operational Capacity of the UEP	**12,000**	**451,000**	**463,000**
1.1. Consulting Services		332,000	
1.2. Equipment	4,000	18,000	
1.3. General Support and Services	8,000	101,000	
2. Studies	**128,000**	**595,000**	**723,000**
2.1. Insurance Sector	37,000	165,000	
2.2. Capital Markets	34,000	160,000	
2.3. Harmonization of Reg.& Sup. of Financial Conglomerates	17,000	80,000	
2.4. Financial Services Tax Reform	10,500	50,000	
2.5. International Accounting and Auditing Standards	10,500	50,000	
2.6. Implementation of International Codes and Standards (FSAP)	19,000	90,000	
Subtotal	**140,000**	**1,046,000**	**1,186,000**
3. Recognition of past tax expenses (IVA)	**45,000**		**45,000**
4. FAPEP		**627,000**	**627,000**
4.1. Recovery of FAPEP		602,000	
4.2. Financial Costs (Credit Commission and Interest)		25,000	
5. Financial Costs related to TC	**15,000**	**160,000**	**175,000**
5.1. Credit Commission (0.75%)	15,000		
5.2. FIV (1%)		20,000	
5.3. Interest		140,000	
7. Contingencies		**167,000**	**167,000**
TOTAL	200,000	2,000,000	2,200,000
%	9.1%	90.9%	100.0%

2. Execution and disbursement period

3.4 The period for executing the TC Program in support of the Financial Services Sector Program will be up to 12 months and the period for disbursement of the funds will be up to 15 months.

IV. MONITORING AND REPORTING

A. Project Reporting

Initial report

4.1 As a condition precedent to the first disbursement of the TC loan, the Executing Agency will submit a work program satisfactory to the Bank and containing a timetable for carrying out the program components and activities. This program shall describe all the activities and indicate benchmarks and means of verification for each activity.

4.2 The Executing Agency will present to the Bank progress reports on the activities being carried out under the TC Program. These reports will be submitted within 30 days of the end of each quarter until completion of the project execution period. These reports should describe the progress being made in each of the components of the TC Loan, as well as the problems encountered and include a plan of activities for the next reporting period. Attached to the progress reports

will be revised lists of the activities carried out and consulting services hired for that period. The progress reports will help to establish the agenda for discussions with the Bank Project Team and for preparation of the work. The Bank Project Team will evaluate these reports and respond to the EUP with comments in a timely way.

4.3 Based on the progress reports submitted to the Bank and within two months following the completion of the TC Loan execution period, a final report will be submitted. It will describe the activities carried out and the results obtained, and compare them with the objectives originally proposed for the operation. It will include explanations for any major discrepancies.

Accounting and financial systems

4.4 UEP shall integrate under a single consolidated accounting and financial system the transaction done with resources from the program following the standard accounting system approved by the Bank.

Disbursements

4.5 UEP shall open an exclusive account to receive Technical Cooperation funds. Disbursements will be made based on ex ante information provided by the UEP. UEP shall keep and save original contracts, bills and any other document required to be checked and analyzed, either by the Bank staff or independent auditors, in relation with any information delivered to the Bank. Bank staff or auditors will review random samples of the mentioned documentation checking to insure that Bank funds have been used according with Bank Policies.

B. External Auditing

4.6 The Bank and the Executing Agency agree that the Bank will have the right to request financial reports on the use of the resources of the loan. These reports will be audited by the Government's auditing branch, *Auditoria General de la Nación (AGN)*, and if this should not prove feasible, by independent external auditors..

C. Procurement of goods and services

4.7 The procurement guidelines of the Bank will be followed in purchasing goods and services financed by the TC Loan. Two exceptions to Bank policy are sought.

4.8 The first is with regard to the Bank's competitive bidding procedures as the Coordinator General was hired in mid-2000 by the Government. The second

relates to a possible conflict of interest as the Coordinator General assisted in preparing this TC proposal. The Government wishes this person to continue as Coordinator General because of their excellent profile and for reasons of Program continuity. For this reason exceptions to competition and conflict of interest are sought.

4.9 The remaining staff of the UEP were hired under the Bank Pre-investment Loan (925/OC-AR) or shall be contracted following the Bank's procedures.

Technical Cooperation Loan (AR-0284)
in Support of the Financial Services Sector Program
Procurement Plan

Category	Type Acquisition	Cost US$	% Financ. Local	IADB	Method	Prequalified	Pub
erational Capacity of the UEP							
nsulting Services	C/I	332,000	0%	100%	AD	Yes	[illegible]
uipment	Goods	22,000	17%	83%	LB	No	[illegible]
neral Support and Services	C/I	109,000	8%	92%	INV	Yes	[illegible]
udies							
urance Sector	C/I	202,000	18%	82%	INV	No	Ye
pital Markets	C/I or CF	194,000	17%	82%	INV	Yes	Ye
rmonization of Reg. & Sup. Of Financial Conglomerates	C/I	97,000	17%	82%	INV	No	Ye
ancial Services Tax Reform	C/I	60,500	17%	83%	INV	No	Ye
ernational Accounting and Auditing Standards	C/I	60,500	17%	83%	INV	No	Ye
plementation of International Codes and Standards (FSAP)	C/I	109,000	17%	83%	INV	No	Ye

: Direct Contracting
/: By Invitation
: Individual Consultant
: Consulting Firm
: Limited Bidding

ARGENTINA FINANCIAL SERVICES SECTOR TECHNICAL COOPERATION LOAN (AR-0284)

LOGICAL FRAMEWORK

BJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
t the Government of n its reform of financial mplementing the Financial tor Program.	Economic and financial indicators that reflect a strengthened Argentine financial system.	Economic and Financial reports published by the Government as well as the IMF.	Government maintains a macroecon program consistent with the objectiv Financial Services Sector Program a reforms are implemented.
e timely technical ce.	Studies completed.	The studies.	Reforms are implemented.
nents the project imple- nit (*Unidad Ejecutora del* JEP)	UEP to carry out its functions and activities as described in Annex A of the TC Loan Agreement	Internal reports and budgets prepared by UEP.	Support from Ministry of Economy.
	Complete studies described in Annex A of the TC Loan Agreement and the Sector Loan Agreement.	Final reports from consultants and internal reports of the UEP.	Regulators willingness to participate Program.
to UEP to carry out the studies.	US$ 463,000 -consultants to support UEP hired. -equipment installed. -general services support hired.	Regular Progress Reports and audited financial statements.	Qualified consultants identified and
n the financial health of industry.	US$ 202,000 Complete studies to undertake a comprehensive financial review of companies to assess actual net worth.	Final report from the consultant.	Regulator willing to participate in in Qualified consultant identified and a

BJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
ote capital markets ment by providing to develop a strategy and Markets Policy ent.	US$ 160,000 Complete studies to support Government's strategy for developing the sector.	Final Report which analyzes and reviews private sector work, providing recommendations and directions. Additional reports as needed to fill in gaps and a Capital Markets Policy Document.	Regulator willing to participate i and MAE and MERVAL's coopera of private sector study and super assessment. Positive market per initiative.
st Government in nization of other areas of ision and regulation omerates); financial s tax reform; tional standards for ting and auditing; and ternational codes and rds for risk management ncial services.	Harmonization – US$ 97,000 Tax Reform - US$ 60,500 Accounting - US$ 60,500 Risk Management- US$ 109,000 Studies successfully completed to provide input to a future sector operation.	Terms of Reference (TORs) prepared for insurance studies, consultants hired, progress reports prepared every three months. Completed Studies of harmonization of other areas of supervision and regulation (conglomerates); financial services tax reform; international standards for accounting and auditing; and for international codes and standards for risk management of financial services.	All superintendents willing to pa initiative and companies cooperate market perception of initiative. Coo other Government agencies (tax aut private sector groups involved in auditing and actuarial; practices Qualified consultants identified and

PROPOSED RESOLUTION

ARGENTINA. LOAN /OC-AR
TO THE NACION ARGENTINA
FINANCIAL SERVICES SECTOR PROGRAM

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Nación Argentina, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Financial Services Sector Program. Such financing will be for the amount of up to five hundred million dollars of the United States of America (US$500,000,000), which are part of the Single Currency Facility of the Ordinary Capital resources of the Bank, and will be subject to the "Special Contractual Conditions" and the "Financial Terms and Conditions" of the Executive Summary of the Loan Proposal.

PROPOSED RESOLUTION

ARGENTINA. LOAN FOR TECHNICAL COOPERATION /OC-AR TO THE NACION ARGENTINA FINANCIAL SERVICES SECTOR PROGRAM.

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is hereby authorized, in the name and on behalf of the Bank, to enter into such agreements with the Nación Argentina and to adopt such measures as may be necessary for the execution of the proposal referred to in Document ____ with respect to a loan for technical cooperation to support a Financial Services Sector Program.

2. That up to the equivalent of two milllion dollars of the United States of America (US$2,000,000), is authorized for the purpose of this resolution, chargeable to the the Single Currency Facility of the Ordinary Capital resources of the Bank.

3. That the above-mentioned sum is to be provided on a reimbursable basis, in accordance with the relevant conditions set forth in the corresponding Technical Cooperation Loan Agreement.