

**TECHNICAL COOPERATION LOAN IN SUPPORT OF THE  
COMISION NACIONAL BANCARIA Y DE VALORES DE MEXICO**

**(ME-0059)**

**EXECUTIVE SUMMARY**

**BORROWER:** Nacional Financiera S.N.C. (NAFIN)

**GUARANTOR:** United Mexican States

**EXECUTING AGENCY:** Mexican Banking and Securities Commission

**AMOUNT AND SOURCE:**

IDB: (Single-Currency Fac.)	US\$ 8 million (OC)
Local contribution:	US\$ 8 million
Total:	US\$16 million

**TERMS AND FINANCIAL CONDITIONS:**

Amortization period:	20 years
Disbursement period:	5 years
Interest rate:	variable
Inspection and Supervision:	1%
Credit fee:	0.75%

**OBJECTIVES:** The purpose of the program is to strengthen the CNBV's operating capacity. Its specific objectives include: (i) consolidating the progress made in banking supervision; (ii) setting the supervisory standards for all the financial intermediaries (in particular the development banks and the auxiliary credit organizations) at a uniform level; (iii) monitoring the supervisory needs of the securities market; (iv) developing a human resource management system defined as a civil service career based on excellence and a continuous training process; and (v) developing an effective information technology support for the efficient performance of the foregoing.

**DESCRIPTION:** To achieve the stated global objective, the adopted plan will be a flexible one based on the definition and execution of semi-annual operating plans (OPs) for the first year and annual plans for the subsequent years. The OPs will be prepared by the CNBV and agreed to by the Bank. The manner in which the budget will be allocated will be specified accordingly in the OPs in order to accomplish the program's objectives. Using this flexible approach, two main groups of activities will be financed:

(a) Activities aimed at modernizing the supervisory processes, methodologies and practices, which include actions to strengthen the supervisory areas of the development banks, the auxiliary credit organizations

and the securities market; training activities in support of supervision; and specific actions considered critical for the consolidation or increased supervision of the full-service commercial banks. (Estimated at US\$8 million).

(b) Activities aimed at consolidating the operating platform that supports supervisory work, including the consolidation of the supervisory support systems, development of the external network, development of the information technology supervisory mechanisms and consolidation of the administrative management systems. (Estimated at US\$8 million).

Program funds would be used to finance: (i) consulting and technical assistance services; (ii) organization and subcontracting of specialized training courses and seminars; (iii) technical exchange and training visits with comparable institutions elsewhere in the world that employ vanguard supervisory methodologies or have experience relevant to the Mexican case; and (iv) procurement of equipment and tools that will form the operating platform. Recurrent costs would not be financed.

In order to coordinate program execution --including review and approval of the OPs-- a high-level management working team will be named by the CNBV to deliberate and make decisions concerning the program execution. For its part, the IDB will delegate an officer from the Finance and Basic Infrastructure Division of Region II (FI2), who will coordinate the monitoring of the program with the Country Office. The Country Office will retain responsibility for the monitoring of the procurement procedures for goods and services.

Within 20 days of submission of the first proposed OP, the CNBV and the IDB will meet to review and agree on the OP. 30 days prior to completion of the set execution period for each OP, the CNBV will submit the proposed OP for the next period. Within the following 20 days, the IDB will meet with the CNBV to evaluate --on the basis of the relevant monitoring indicators-- the activities carried out in the preceding period. The detailed OPs for the subsequent period will also be formulated during that time. In addition, *semi-annual monitoring meetings* will be held to evaluate the progress of the OPs and to consider any difficulties that may have arisen in the course of their execution and how they can be solved.

*A general mid-term evaluation of the program will be made before the third year of execution of the Program or when half of the program funds have been committed, whichever occurs first.*

*This evaluation shall verify, in particular, whether the general objectives of the program are being met, and, if need be, make the necessary adjustments to ensure that these objectives are attained. Finally, as part of the activities that will be included in the last OP, a final evaluation of the program's achievements will be made.*

**THE BANK'S COUNTRY  
AND SECTOR STRATEGY:**

In supporting the initiatives to strengthen the regulation, inspection and supervision of the financial and securities system, the proposed program is consistent with the objectives of the Bank's strategy in Mexico. The existence of a financial system and a securities market that are reliable, solvent and efficient is one of the fundamental requirements for promoting sustainable growth. The 1995 crisis demonstrated the macroeconomic costs of an unconsolidated financial system and the financial costs of the rescue programs.

**ENVIRONMENTAL  
CLASSIFICATION:**

The Environmental Committee, at its meeting of October 6, 1997, confirmed that the proposed program will not have any environmental impact, but will have favorable indirect effects on social equity by introducing elements that will help prevent financial crises.

**BENEFITS:**

This program is designed to have the response capacity needed by a sound institution in the process of consolidation; thus, it is not based on a pre-definition of projects but on a "general business plan" to which the CNBV and the Bank have agreed. In accordance with this plan and with the procedure already agreed to, the specific actions to be financed will be defined. By offering support to the CNBV in the implementation of its development strategy, on the basis of OPs which have been discussed at a high management level, the Bank is forging a strategic alliance that will be sustained by means of a continuous dialogue. The program will thus become a vehicle for dialogue between the Bank and the Mexican authorities regarding the development of the financial and securities system.

This program complements other Bank actions aimed at supporting capital markets' development, promoting

their efficiency and transparency and boosting the saving and investing public's confidence.

**RISKS:**

The greatest risk connected with the operation is that -although designed as a business plan that will be actively revised by the parties in the course of its execution- if executed in a traditional fashion, as an investment program, it would result in inefficient resource allocation. The following steps have been taken to mitigate this risk: (1) a highly effective level of dialogue and decision-making has been built into the review of the annual OPs and the semi-annual reviews; (2) the execution objectives and procedures have been clearly defined; and (3) precise goals and specific budgets will be included in the semi-annual reviews, and the institutional capacity for effectively and efficiently absorbing the support programs will be analyzed. The monitoring of the program will require an exceptional commitment on the part of the Bank in terms of human resources, both internal and external, compared with similar operations. This cost will produce a more efficient technical dialogue.

In the information systems area, it is vital to avoid over-sizing and procurement of equipment and software not planned as part of an integral information system management strategy. Here too, the annual OPs will be the main tool for minimizing this risk, and the technical support provided by the Bank becomes more important.

The extent of the Government's commitment to the program is critical to its successful execution. This commitment has been evident in the authorities' involvement in the design of the operation to date, and even more so in the Government's decision to transfer federal funds to the CNBV for its implementation. A key element of the program is the introduction of specific mechanisms to ensure that counterpart funding will be available each fiscal year.

**SPECIAL  
CONTRACTUAL  
CONDITIONS:**

- (a) As a condition prior to the first loan disbursement, the CNBV will have to submit the following: (i) Evidence that the CNBV's President has named the team responsible for adopting the necessary decisions for coordinating the program's execution (para. 3.28); (ii) The first semi-annual OPs, including the pertinent procurement plan (paras. 3.25, 3.34 ff and 3.45

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(i)); and (iii) Updated information on the accomplishments achieved in the technical assistance program financed by the World Bank and the global investment plan for 1998 (para. 1.8, 3.2, 3.45 (ii)).

- (b) As a prerequisite for disbursement of the funds for the information systems area, the CNBV will also be required to submit: (i) A technical update of the present status of the institutional information systems strategy and computer equipment; and (ii) an update of the accomplishments achieved in the Technical Assistance Program financed by the World Bank in the information systems area and the investment plan for 1998 for that area (para. 3.21 and 3.46 (ii)).
- (c) The loan contract will contain sufficient provisions for ensuring timely holding of meetings for defining and evaluating the annual OPs, and also for ensuring that the estimated data needed for the pertinent evaluation and review are on hand at those meetings. (para. 3.44 and Annex II).

**IMPACT ON POVERTY:** N/A

**EXCEPTIONS  
TO BANK  
POLICY:**

N/A

**CEILING AMOUNT  
FOR PROCUREMENT:**

In accordance with the guidelines suggested as reasonable for other projects carried out in Mexico, international competitive bidding will be obligatory for procurement of goods and services exceeding US\$350,000, and for the contracting of consultancy services exceeding US\$200,000. The detailed procurement program for goods and services will be specified in the OPs. For each OP, the pertinent procurement plan will require clearance by the Bank's Procurement Office.

## **I. BACKGROUND**

### **A. Introduction**

- 1.1 The purpose of this document is to present a proposal for a technical cooperation program in support of the Comisión Nacional Bancaria y de Valores de México [Mexican National Banking and Securities Commission] (CNBV). This chapter sets out the program's background and Chapter II summarizes the program's objectives. Chapter III presents a description of the program, its organization and the procedures for its execution. Chapter IV then concludes by discussing the benefits and risks of the program.

### **B. Context of the financial and securities market**

- 1.2 The operation will be carried out in a macroeconomic context that is showing signs of gradual recovery; after the 5.1% growth posted in 1996, the growth forecasts for 1997 and 1998 remain in the moderate range (4%). The slowing of inflation <sup>1/</sup>, coupled with a better liquidity position in foreign exchange, has enabled the Bank of Mexico to somewhat ease its monetary policy, which is being reflected in a downward trend in interest rates. However, the stability of the real exchange rate remains a determining factor for the Bank of Mexico's intervention in the monetary market.
- 1.3 After two years of economic crisis in Mexico, and despite massive government support to prevent a collapse of the financial system (between 8.5% and 12% of the GDP in liquidation, capitalization and debt-restructuring programs and purchase of bad portfolio), there is now leeway for adjustment (capital base and portfolio quality) and it is expected that the institutional consolidation will continue. For its part, the Stock Exchange is recovering gradually as the economic recovery forecasts improve. A Derivatives Exchange and the related clearing house for futures contracts are expected to begin operation shortly.

### **C. Supervisory and inspection systems**

- 1.4 The Bank of Mexico and the Secretaría de Hacienda y Crédito Público [Ministry of Finance and Public Credit] (SHCP) set the policies and establish the legislation concerning financial intermediation and the CNBV --which defines the standards and specific regulations in consultation with the Bank of Mexico-- performs the regular supervision and inspection activities. The CNBV reports to the Bank of Mexico and to the SHCP, under whose oversight it formally falls as a deconcentrated agency with technical autonomy and executive

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<sup>1/</sup> Inflation is expected to run at 18% for 1997, compared with 35% in the two preceding years.

powers. The sources of financing for the CNBV's activities are contributions made by the entities supervised 2/.

- 1.5 In April 1995, the Comisión Nacional Bancaria [National Banking Commission] CNB and the Comisión Nacional de Valores [National Securities Commission] (CNV) were merged in order to make consolidated supervision of the financial markets more efficient 3/. In addition to traditional supervisory work, the CNBV has played a central role in the design and execution of the support plans and programs for the Mexican financial system. The CNBV is also involved in the management of the entities placed under government control (a total of six with assets equivalent to 20% of the system), and is very active in the direct dialogue with financial entities for defining capitalization programs.

**D. Program of the CNBV by activities**

- 1.6 Given the dynamics imposed by the 1995 economic crisis, in the first two years of its existence, the new CNBV's institutional development program was dominated by the actions aimed at containing the banking crisis. As of 1997, the CNBV has drawn up an integral program for institutional strengthening for the period 1997-2000 that will enable it to: (i) consolidate the progress achieved in the area of banking supervision; (ii) bring the supervisory standards of all financial intermediaries (in particular the development banks and the auxiliary credit organizations) up to a uniform level; and (iii) strengthen the supervisory needs of the securities markets, including development of supervisory mechanisms for the emerging markets. The operation proposed in this document is aimed at providing comprehensive support for this CNBV program.

**E. Recent support programs**

- 1.7 The Bank has supported the process for restoring the stability and soundness of the financial system through the sector program co-financed by the World Bank (ME-0188; PR-2041), which has been satisfactorily completed. That program included a combination of

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2/ The level of the contributions and the methodology for calculating them change depending on the type of intermediaries. The estimated budget for 1997 is US\$95 million.

3/ The CNBV has approximately 1,500 employees, 1,200 of whom have qualifications at *licenciatura* (master's) level or higher and hold specialized positions in the following areas: supervision of financial intermediaries (45%), supervision of financial markets (6%), analysis of financial and legal aspects (20%), financial analyses and studies (9%), financial information systems (7%), management information systems (11%), and institutional coordination (2%). Annual salary costs make up about 85% of the total annual budget. CNBV salary levels are equivalent to those of the SHCP.

short-term actions, designed to lessen the commercial banks' financial problems, and medium-term measures intended to strengthen the efficiency and transparency of the financial system's institutional and regulatory framework. Specific actions were included for modernizing the prudent regulations, strengthening banking supervision and increasing the transparency and precision of financial statements.

- 1.8 These programs were complemented by two technical assistance programs targeting the CNBV, the National Insurance and Guarantees Commission, the National Commission of the Systems for Retirement Savings and the SHCP Investment Unit. The sum total of the two programs is US\$36.7 million, financed by the World Bank. US\$27.3 million of this figure was allocated directly to the CNBV to support and strengthen the supervision of financial groups and commercial banks, including diagnostic studies of the banks placed under government control and studies for their restructuring. A balance of US\$4.2 millions will remain for 1998 which will be applied, basically, to consolidating the progress in the area of regulation, supervision and information systems development programs that are presently being financed and will be finished with World Bank support.

**F. Technical assistance requirements**

- 1.9 On January 29, 1997 the Mexican government requested a technical cooperation loan from the Bank to support the CNBV's institutional development plan. The objective of this plan is to increase CNBV's efficiency and strengthen its operating capacity. The primary areas of support would be: (1) strengthening of supervision in the areas which received less attention in the crisis years and which need to be updated; (2) supervision of securities markets to cover a market that is currently undergoing a dynamic transformation; (3) training in support of supervision; and (4) consolidation and development of the operating platform.
- 1.10 There are no sector adjustment operations currently being executed. The World Bank's Technical Assistance Program, focused on the commercial banking area as a result of the crisis, will be completed in 1998. The proposed technical cooperation program will therefore fill a gap that is not covered by other multilateral agencies. It will also enable the establishment of a solid channel for dialogue with the government on the entire process of consolidating the country's supervisory and inspection systems.

**G. Bank strategy**

- 1.11 In supporting the initiatives to strengthen the systems for regulation, inspection and supervision of the financial and securities system, the proposed program is consistent with the objectives of the Bank's strategy in Mexico. The existence of a financial system and a securities market that are reliable, solvent and efficient is one of the basic prerequisites for fostering



sustainable growth. The 1995 crisis underscored the macroeconomic costs of an unconsolidated financial system and the financial costs of the rescue programs.

**H. Bank experience in similar programs**

- 1.12 The IDB has supported the execution of various programs that support the strengthening of national supervisory agencies of the financial and securities systems 4/. The programs have been a mix of direct technical assistance, training and information system modernization, and have been set up as components of sector adjustment (financial or investment) programs, multisector programs and technical cooperation operations (with IDB and/or MIF funding). The availability of funds has enabled the supervision agencies an accelerated methodological, professional and information technology renewal. Without that renewal there would have been negative repercussions for the reliability, soundness and solvency of the financial and securities systems, some of which were in the process of recovery following a crisis.

**II. PROGRAM OBJECTIVES**

- 2.1 The program is designed to strengthen the operating capacity of the CNBV. Its specific objectives include: (i) consolidating the progress achieved in the area of banking supervision; (ii) raising the supervisory standards of all financial intermediaries (in particular the development banks and the auxiliary credit organizations) to a uniform level; (iii) meeting the supervisory needs of the securities market; (iv) developing a human resources management system defined as a civil service career based on excellence and a process of continual training; and (v) developing information system support appropriate for the effective accomplishment of the tasks set forth.

**III. DESCRIPTION**

**A. Activities**

- 3.1 The program will support the CNBV's institutional development plan, and especially the actions designed to strengthen supervision of the development banks and the auxiliary credit organizations, as well as development of supervision of securities markets. To complement these actions, training activities in support of supervision will be carried out. In addition, investments needed for consolidating and developing the operating platform will be financed 5/. The program

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4/ Including operations in Uruguay, Jamaica, Perú, Dominican Republic, El Salvador, Honduras, Paraguay and Costa Rica.

5/ Operating platform is understood to mean both hardware and software and the support services for its efficient use. As a general rule it is considered desirable that the ratio of hardware to software should not exceed 3:7.

will also support, on an exceptional basis, specific actions considered critical to consolidating or developing the supervision of full-service commercial banks.

- 3.2 Program funds would be used to finance: (i) consulting or technical assistance services; (ii) the organizing and subcontracting of specialized training courses and seminars; (iii) technical exchange visits and training in similar institutions elsewhere in the world that employ state-of-the-art supervisory methodologies or have experience that is relevant to the Mexican case 6/; and (iv) the procurement of the equipment and tools that make up the operating platform. Recurrent costs will not be financed.

**B. Program design**

- 3.3 In light of the nature of the program, it is recommended that a flexible execution plan be adopted subject to some well predefined rules for implementation. Accordingly, within the framework of the CNBV's institutional development plan for 1997-2000, the execution of the technical cooperation program includes: (i) clear global objectives; (ii) predefined areas of financeable activity; and (iii) pre-established procedures for the drawing up of annual operating plans --apart from the first two which will be semi-annual -- that will have to be approved by the Bank.
- 3.4 Inclusion of activities in the operating plans will be subject to the program's objectives, their being consistent with the lessons learned in the course of implementation of the CNBV institutional development plan and its demonstrated cost-effectiveness.
- 3.5 The priority areas that would be supported with program funds are set out below, together with the specific objectives and goals to be achieved as a result of the program activities which, in their turn, will be reviewed and spelled out in the annual plans of operations.

**C. Operating plans and activities by area**

**1. Expansion and development of the supervisory mechanisms of the securities market**

- 3.6 The Mexican Stock Exchange is made up of 32 brokerage firms. Of the total number of companies quoted (162), only 49 are considered to

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6/ A central element of the program is the fostering of dissemination, understanding and adoption of efficient supervisory methodologies. Since direct exposure to practical use of these methodologies is a very effective means of transferring know-how and efficient operating practices, it is considered desirable that a selected group of CNBV staff should have direct access to institutions elsewhere in the world that are developing and applying vanguard methodologies.

have a high or medium level of marketability. Of the balance of fixed-interest securities, 65% are public sector issues, 15% banking sector issues and the remaining 20% private company issues. The Mexican stock market has a complete regulatory system based on principles consistent with the practices of the most advanced markets. The Mexican Stock Exchange has some self-regulating capacity which is exercised through its bylaws. These self-regulating powers will be greater in the case of the Future Derivatives Exchange.

3.7 Regarding provision of information and supervision of market activities, supervision of electronic trading systems, and clearing and processing of securities, there is considerable opportunity for modernizing and bringing up to date the regulatory and supervisory systems. The program would finance a comparative evaluation with other markets and the development of amendments and adjustments needed to change the current regulations.

3.8 For its part, the introduction of a Derivatives Exchange with its related clearing house will constitute a structural change in the *modus operandi* of the securities market. Interaction and exchange with regulators in other countries is a valuable source of know-how and an effective means for acquiring the most efficient supervisory methodologies and processes. Furthermore, access to specialized consultants is vital for supporting the CNBV's staff in adapting these methodologies and processes to the Mexican case.

3.9 Another area that needs support is the strengthening of the regulations and mechanisms for supervising investment funds. These funds play a key role in the development of the capital market, and particularly in the context of pension system reform. The support for this important supervisory area will be evaluated throughout the program.

## 2. Modernization of the supervisory mechanisms of the development banks

3.10 The CNBV is responsible for the supervision of both the development banks and their affiliates, as well as the public trust funds created by the Mexican government to support various sectors of the economy. Altogether, this amounts to US\$90 billions in assets (33% of the credit institutions' assets) even though represents only 3.4% of the institutions supervised by the CNBV.

3.11 During the economic crisis period that began in 1995, preference was given to strengthening supervision of the private commercial banks, which explains why supervision of the development banks is now behind in terms of technical and human resources and information systems. The supervision that is currently being performed is primarily along the lines of account inspection, and does not address financial aspects or quantification of risks according to the different type of activities carried out by the banks.

Moreover, the information systems support only partially covers the development banks area and does not cover the trust funds.

- 3.12 Program funds would be used to support the modernization of the procedures and tools employed for supervisory purposes. Technical exchange visits with other supervisory agencies would be included as part of the program, as would studies and technical support, training programs of different levels, and strengthening of information technology methods and procedures.
- 3.13 The development banks' supervisory modernization effort that this technical cooperation program supports must take place within the revision process framework laid out by the Mexican government regarding these banks' future role.

3. Modernization of the supervisory mechanisms of the non-consolidated auxiliary organizations

- 3.14 The CNBV is responsible for supervising the performance of 243 auxiliary credit organizations that are not consolidated with other intermediaries 7/. These include organizations that do not receive savings from the public (leasing firms, factors, general warehouses, exchange houses and limited-purpose companies) and others that do (savings and loan companies--SLCs--and credit unions--CUs). The solvency and stability of this second group of financial intermediaries directly impacts the interests of the savers and the public's confidence in the financial system. Since a very sizable universe of varied organizations is involved, the supervision costs are high and the traditional supervisory methodologies are inefficient and not readily adaptable to the evolution of the financial system.
- 3.15 During the crisis period, and operating without the levels of support received by the commercial banks, the Directorate General of Supervision of Non-Consolidated Auxiliary Organizations initiated, with the tools at its disposal, an intensive process of consolidation of these organizations 8/. After this process is finished, the CNBV considers it a priority to upgrade the supervision of the organizations that receive savings from the public (SLCs and CUs), which were also the ones in which the greatest deficiencies in management and financial soundness are found.

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7/ Active authorized organizations only. This figure does not include organizations whose licenses have been revoked or are in the process of revocation.

8/ Since 1995, the licenses of 12 leasing firms, 19 factoring firms, 5 general warehouses, 6 exchange houses, 6 limited-purpose companies, 4 SLCs and 253 CUs have been revoked or are in the process of revocation.

3.16 In accordance with the guidelines of the CNBV institutional development program for 1997-2000, the program would support the adoption of new supervisory, inspection and evaluation methodologies, procedures and strategies that will make it possible to supervise the auxiliary credit organizations more efficiently.

3.17 One aim of the Program will be to study --by means of technical exchange visits to other supervisory agencies-- the experience gained by others regarding the operation, regulation and supervision of comparable organizations in other countries. To ensure effective incorporation of pertinent amendments and adjustments, training programs and strengthening of information technology support would be included.

4. Support for the execution of the training programs with emphasis on the in situ and extra situ supervisory personnel

3.18 Since 1995, through a combination of internal and external projects, the CNBV has been carrying out extensive training programs. Thanks to the financial support from the World Bank, in the past three years the CNBV has had access to specialized training courses --not available at the national level-- which are key to maintaining high levels of efficiency in supervisory work. The applied nature of the courses has meant that the updating and training in better financial supervisory methodologies and practices have swiftly upgraded the quality and relevance of those methodologies and practices employed in Mexico. The adoption of the MACRO evaluation system (comparable with the international system known as CAMEL), the development of the financial analysis system (FAS) and the introduction of international accounting standards are examples of the immediate benefits of the training done.

3.19 The CNBV is convinced of the importance of maintaining a high level of technical and professional excellence. To achieve this goal, a civil service system has been developed together with an internal training system to support it. Based on the assessment of training needs by area, the CNBV is currently developing specific programs and institutional arrangements needed for setting up and operating an internal training center. The courses offered would basically be of a specialized technical and management nature. To begin with, it is expected that the training center will focus on the CNBV's training needs, although it could eventually also serve the training requirements of other banking and securities supervisory agencies in Latin America.

5. Consolidation of the operating platform

3.20 In 1995 the CNBV started a program of information technology renewal. In that year, its actions were limited to the updating of basic equipment and managing of emergency situations in specific areas.

- 3.21 Since 1996 a more integral technology renewal process has been underway, aimed at: (1) surmounting the technological incompatibility problems that arose as a result of the merging of the CNB and the CNV, by standardizing and updating the information technology infrastructure; (2) establishing an institutional database and efficient access instruments; (3) developing an internal network plan; (4) modernizing the computer equipment (hardware and software) of the financial system analysts and inspectors, with initial emphasis on commercial banks; and (5) modernizing the equipment and support systems for the CNBV staff 2/.
- a. *Consolidation of the support system for supervision*, including efficient automation of processes and standardization of the levels of service and tools for the various units performing supervisory work. This includes the upgrading of the automated alarm and risk analysis programs and of the monitoring instruments in emerging markets.
  - b. *Development of an external network* for ensuring efficient communication with the institutions supervised and with the public, in particular for (i) expanding the automated processes for gathering and validating data processed by the CNBV; and for (ii) automating and expanding the mechanisms for informing the public regarding the regulations, requirements and financial analyses.
  - c. *Development of the procedures, techniques and practices for performing the supervision of computerized systems*, a new function of the CNBV's Directorate General of Information Technology, resulting from the needs imposed by a highly systematized environment in which minimum process standards, contingency plans and security guarantees have to be established for the institutions supervised by the CNBV.
  - d. *Consolidation of the administrative management systems*, especially development of systems that support the new civil service career.

D. Organization and execution

1. Borrower, guarantor and executing agency

- 3.23 The borrower of the operation will be Nacional Financiera S.N.C. (NAFIN), as financial agent for the federal government and with the latter's guarantee. The executing agency will be the CNBV.

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2/ To carry out these activities the CNBV has made a considerable investment (figure in parentheses is the percentage of the investment financed by the World Bank): In 1995 US\$1.6 million (60%) and in 1996 US\$2.7 million (70%), while the investment budgeted for 1997 is US\$12 million (25%).

## **2. Beneficiaries**

- 3.24 The direct beneficiary will be the CNBV. Given the range of actions aimed at making the supervision of financial intermediaries more efficient, the indirect beneficiaries will be the financial institutions supervised and the general public that saves and invests.

## **3. Technical aspects of execution**

- 3.25 To achieve the Program's global objective, the execution plan will be flexible based on the creation and execution of annual operating plans (however, the first two will be semi-annual) prepared by the CNBV and to be agreed on with the Bank. The content of the plans is presented in Annex I.
- 3.26 With the exception of the last operating plan, the operating plans will be required to include specific activities for the preparation of the subsequent operating plans. The Program will finance the required activities to perform the midterm and the final evaluations. Therefore, evaluation related activities should be included in the operating plans.
- 3.27 As part of the information that will be reviewed in the operating plans, a report will be included on the disbursements of the counterpart funds for the execution of the preceding operating plan(with the exception of the first).

## **4. Operational set-up for execution**

- 3.28 In order to coordinate the execution of the program --including the review and approval of the operating plans-- a working team will be designated in the CNBV. This team will deliberate on and make the decisions for the execution of the program. The IDB will delegate a project team to facilitate the necessary coordination between the CNBV and the Bank.
- 3.29 The CNBV working team will be comprised of: (1)the officer responsible for technical general coordination in the Office of the President of the CNBV; and (2) the vice presidents of support areas, in matters pertaining to their specialties. If the annual budget proves insufficient to cover all support proposals, the allocation of funds among the areas will be made by the Office of the President of the CNBV.
- 3.30 In the CNBV, responsibility by area will be as follows:

Area	Coordination	Basic responsibility
Modernization of the mechanism for supervision of development	General Technical Coordination Office of the Office of the President	Directorate General of Supervision of Development Banks
Modernization of the mechanisms for supervision of the non-consolidated auxiliary organizations	Office of the Vice President for Specialized Supervision	Directorate General of Non-consolidated Auxiliary Organizations
Expansion and development of mechanisms for supervision of the stock market	Office of the Vice President for Supervision of Securities Market Affairs	Directorate General of Securities Issuers
Consolidation and increased thoroughness of the supervision of commercial banks	Office of the Vice President for Integral Supervision	Directorate General of Financial groups and Banks (A and B)
Support for the execution of the training programs	General Technical Coordination Office of the Office of the President	Directorate General of Planning
Consolidation and development of the operating platform	Office of the Vice President for Financial Analysis and Development	Directorate General of Information Technology

3.31 In the event that functional reassignments or reassign-ments of responsibilities within the CNBV are made, the responsibilities by area will be adjusted accordingly.

3.32 The general management of the program will be the responsibility of the General Technical Coordination Office of the Office of the President, which will handle inter-institutional coordination with support from the Directorate General of International Affairs.

3.33 The IDB will designate an officer from the Finance and Basic Infrastructure Division of Region II (FI2), who will coordinate the program monitoring activities with the Country Office. The Country Office will retain responsibility for the monitoring of the procurement procedures for goods and services.

#### **E. Monitoring and program evaluation**

3.34 Within 20 days of submission of the first operating plan by the CNBV, the IDB technical team will meet with the CNBV coordinating team to review and agree on the first operating plan, which must meet the information requirements set forth in Annex I.

3.35 Within 30 days prior to the completion of the execution period for each operating plan (every six months for the first two operating plans), the CNBV will submit the proposed operating plan for the next period in accordance with the guidelines set forth in Annex I. Within 20 days of submission of the operating plan, the Bank will meet with the CNBV coordinating team. Thus --on the basis of the pertinent monitoring indicators-- the activities carried out in the previous period can be evaluated against the pertinent OP, and the detailed operating plans for the next period can be formulated.



- 3.36 In addition, the Bank's technical team and the CNBV will hold semi-annual monitoring meetings to assess the progress of the operating plan and to consider any difficulties that may have arisen in its execution, and how best they can be surmounted. If considered appropriate, extemporaneous technical missions can be undertaken, at the request of the CNBV or the Bank.
- 3.37 Following the disbursement of 50% of the financial resources or, at the latest, three years after the program's execution, the subsequent semi-annual meeting will have the added objective of undertaking a general evaluation of the program. This evaluation will be undertaken utilizing the evaluation indicators taken from the previous operation plan. This evaluation will review in particular whether the general objectives of the program are being met and, if necessary, make the appropriate adjustments to ensure that said objectives are accomplished.
- 3.38 As part of the activities that will be carried out in developing the last OP, a final evaluation of the program's accomplishments will be formulated. Based on the evaluation indicators presented in each operating plan, the evaluation should include concrete data on goals achieved in the context of the program and will be reviewed in the last monitoring mission.

**F. Total cost and financing**

- 3.39 The total cost of the proposed program is US\$16 million, as follows: (i) US\$8 million from the Single-Currency Facility of the Bank's Ordinary Capital; and (ii) US\$8 million from the Mexican Government.
- 3.40 It is important to bear in mind that the allocation of resources by support area is tentative, and funds may be reallocated among activities if adequate justification is presented in the operating plans. Subject to this clarification, the costs of the program can be broken down on a preliminary basis into two main groups:
- (a) Activities focused on modernization of the supervisory processes, methodologies and practices, which include the actions aimed at strengthening the supervisory areas of the development banks, the auxiliary credit organizations and the securities market; the training activities in support of supervision; and the specific actions considered critical for the consolidation or greater supervision of commercial banks. Tentatively, it has been estimated that the program will finance activities for US\$8 million.
- (b) Activities aimed at consolidating the operating platform underlying the supervisory work. Tentatively it has been estimated that the program will finance activities for US\$8 million.

- 3.41 The cost and financing by investment category, in dollars, breaks down as follows <sup>10/</sup>.

**Total cost by investment category (in US\$)**

Activities	IDB	Local contribution	Total
1. Modernization of the supervision processes, methodologies and practices	6.000.000	2.000.000	8.000.000
1.1 Basic and advanced training	2.940.000	980.000	3.920.00
1.2 Consultancy services	2.940.000	980.000	3.920.00
1.4 Contingencies	120.000	40.000	160.000
2. Consolidation and development of operating platform	1.920.000	6.000.000	7.920.000
1.1 Basic and advanced training	576.000	1.800.000	2.376.000
1.2 Consultancy services	729.600	2.280.000	3.009.600
1.3 Equipment procurement	576.000	1.800.000	2.376.000
1.4 Contingencies	38.400	120.000	158.400
3. Inspection and supervision	80.000	0	80.000
TOTAL	8.000.000	8.000.000	16.000.000

- 3.42 The Bank financing will be subject to the following financial conditions:

Amortization period	20 years
Disbursement period	5 years
Interest rate	variable
Inspection and supervision	1.00%
Credit fee	0.755

**G. Disbursement and procurement terms and conditions**

**1. Estimated disbursement period**

- 3.43 The disbursement from the loan will be made over a five-year period.

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<sup>10/</sup> The resource allocation favors the information technology area. This is because of the relative costs of the actions in each area. The supervisory modernization and training programs require technical exchanges, courses and seminars, specialized consultancy services and the development of materials which are relatively less costly than the technical solutions (software and hardware) in the information technology area.

**2. Commitment and disbursement authorizations**

- 3.44 The disbursements from the loan will be made in accordance with the IDB's procedures. To facilitate the execution of the operation, establishment of a system permitting an advance of funds of up to the equivalent of 5% of the loan will be allowed.
- 3.45 In addition to the general conditions, such as conditions prior to the first disbursement of the loan, the CNBV will be required to submit to the Bank's satisfaction:
- (i) The operating plans of the first six months for the initiation of the technical cooperation activities, including the corresponding procurement plan.
  - (ii) An update of the accomplishments of the technical assistance program financed by the World Bank and the global investment plan formulated for 1998.
- 3.46 In addition to the foregoing, as a prerequisite for disbursement of the funds for the information technology area, the CNBV will be required to submit to the Bank's satisfaction:
- (i) A technical update of the present deployment of the institutional information technology resources;
  - (ii) An update of the accomplishments of the technical assistance program financed by the World Bank in the information technology area, and the investment plan for 1998.
- 3.47 In view of the importance of having a comprehensive overview of the characteristics and priorities of the information technology development envisioned, the first operating plan for the systems area will be basically devoted to preparation of an implementation plan for the processes and projects expected to be financed with technical cooperation.

**3. Contracting of consulting services and procurement of goods and services**

- 3.48 The procurement of goods and services and the contracting of consulting and training services will be done in accordance with the Bank's rules. On the basis of the guidelines suggested as reasonable for other projects carried out in Mexico, international competitive bidding will be obligatory for procurement of goods and services exceeding US\$350,000 and for the contracting of consulting services exceeding US\$200,000. When the amounts involved are smaller than those stated, international advertising will not be required but rules may not be set that would prevent participation by bidders from Bank member countries. The national legislation may be applied in addition to the Bank procedures, provided its application will not conflict with the pertinent Bank policies. No works will be carried out with program funds.
- 3.49 The contracting of services and procurement will be done by the CNBV. For execution of the agreed actions, the standard bidding documents agreed on by the Mexican government and the Bank will be used. The CNBV has recent experience in applying international bidding guidelines and will use bidding procedures accepted by the Bank.

- 3.50 The goods and services contracting program for each period covered by an operating plan will be agreed on during the administration missions (the pre-execution mission in the case of the first six months) and will be defined on the basis of the agreed operating plans and availability of local counterpart funding. Clearance by the Bank's Procurement Office will be needed for each operating plan procurement plan.

#### **4. Audit of financial statements**

- 3.51 The program's financial statements are to be submitted within 120 days of the close of the CNBV's fiscal year, starting with the fiscal year in which execution of the program is begun and ending in the last fiscal year in which disbursements are made for the program. The financial statements are to be audited by an independent firm of public accountants acceptable to the Bank. The cost of engaging this firm can be covered with funds from the Bank's financing.

#### **H. Environmental quality and social impact**

- 3.52 By its nature, the program will not have any impact of an environmental sort. But it will have indirect effects on the social equity of the financial sector support programs in that it will introduce safeguards against the occurrence of financial crises which frequently lead to losses originating in the private sector having to be borne by society as a whole.
- 3.53 Moreover, as part of the actions designed to improve and complete the information given to the market by securities issuers (what are generally referred to as "significant facts"), a review will be made of international experience in disclosing information on environmental quality and control measures adopted by enterprises (as an important part of risk assessment). The relevance of this experience to the Mexican case will then be assessed.

### **IV. BENEFITS AND RISKS**

#### **A. Benefits**

- 4.1 One of the lessons learned in the technical cooperation programs is that, in fact, ex-post adjustments must be made to take care of the most pressing supervisory needs of the local markets. The possibility of having funds on hand to cover these changing needs has been a key factor in taking timely steps in the regulation, supervision and, at times, rescue areas. This program is designed to provide the response capacity that a sound institution in the process of consolidation needs.
- 4.2 The proposed program is innovative because it is not based on the predefinition of projects but on a "general business plan" shared by the CNBV and the Bank. In accordance with this plan, and with the procedures agreed on beforehand, the specific actions to be financed will be defined. By offering financial support to the CNBV for the execution of its development strategy on the basis of operating plans discussed at a high

management level, the Bank is forging a strategic alliance that will be sustained by a continuous dialogue.

- 4.3 This program complements other Bank actions aimed at supporting development of the capital markets, promoting their efficiency and transparency and boosting the saving and investing public's confidence. It is important to underscore that the program is a vehicle for dialogue on the part of the Bank with the Mexican authorities concerning the development process of its financial and securities system.

**B. Risks**

- 4.4 The greatest risk connected with the operation is that --although designed as a business plan that will be actively revised by the parties in the course of its execution--, if it is executed in a traditional fashion, as an investment program, the result will be an inefficient resource allocation. The following steps have been taken to lessen this risk: (1) a highly effective level of dialogue and decision-making has been built into the review process of the operating plans and the semi-annual reviews; (2) the execution objectives and procedures have been clearly defined; and (3) precise goals and specific budgets will be agreed in the semi-annual reviews. Furthermore, the institutional capacity for effectively and efficiently absorbing the support programs will be analyzed. The monitoring of the program will require an exceptional commitment on the part of the Bank in terms of human resources, both internal and external, compared with similar operations. This should translate in a more efficient technical dialogue.
- 4.5 In the information systems area, it is critical to avoid over-sizing or procurement of equipment and software not planned as part of an integral information system management strategy. Here too, the annual operating plans will be the main tool for minimizing this risk, and the technical support provided by the Bank becomes very important.
- 4.6 The extent of the government's commitment to the program is critical for its successful execution. This commitment has been evident in the authorities' involvement in the operation design, and even more so in the government's decision to transfer federal funds to the CNBV for its implementation. A key element of the program is the introduction of specific mechanisms that will ensure that the counterpart funding installments are available when required in each fiscal year.

# MEXICO: TECHNICAL COOPERATION LOAN IN SUPPORT OF THE MEXICAN NATIONAL BANKING AND SECURITIES COMMISSION (ME-0059) LOGICAL FRAMEWORK

ANNEX

CRITICAL SUMMARY	QUANTIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTION
<p>creation of a system of all financial system intermediaries participating in the Mexican securities market and modern and develops efficient and modern and develops</p>	<p>1. Stability and solvency of the financial system 2. Management of the financial intermediaries and agents participating in the securities market 3. Efficiency and competition in the financial markets 4. Number of dynamic mechanisms for the continuous strengthening of supervision</p>	<p>1. Macroeconomic and financial sector 2. Sector reports and studies 3. Report on institutional consolidation of CNBV</p>	<p>1. Political and macroeconomic conditions supportive of financial system consolidation maintained 2. Continuous government support for better supervision and greater transparent financial system and securities market 3. Private-sector interest in the privatization process</p>
<p>the regulation, inspection and supervision by the CNBV are carried out efficiently, using available and technologies</p>	<p>1. Uniform prudential regulation 2. Efficient financial supervision 3. Effective penalty systems 4. Ample information disclosure systems</p>	<p>1. Prudential regulations in effect 2. Inspection, analysis and supervisory procedures and manuals 3. Reports on corrective actions 4. Public information for individual and institutional investors and for the saving public</p>	<p>1. CNBV maintains its commitment to permanent institutional development 2. The institutions supervised quickly rules and collaborate in the process of a better supervision system 3. CNBV's sources of financing remain</p>
<p>standards for all financial made uniform (including banks and the auxiliary credit methodologies and processes for strengthening, including supervision systems for new systems for commercial banks included in accordance with technical standards source management based in a continuous training process information technology support for performance of the CNBV's work</p>	<p>1. Supervision and inspection methodologies, tools, procedures and strategies that make it possible to perform efficient supervision according to the type of institutions 2. International experience and methodologies adopted for supervision of securities markets and emerging products in accordance with international practices 3. Dynamic mechanism for updating prudential regulation and supervision systems for multiple banks 4. Career civil service in operation, the technical training process is continued and the institutional training center is developed 5. Efficient information technology support for the supervision and inspection work, and also for the operating and administrative functions of the CNBV</p>	<p>1. Technical exchanges. Regulations, procedures, inspection manuals, evaluation reports, published reports Functional adjustments in pertinent divisions 2. Technical exchanges. Regulations and procedures that adapt international experience for new products 3. Technical exchanges. Regulations and procedures revised or expanded 4. Information technology support for career civil service. List of positions and career paths for all CNBV personnel. Creation of training center. National and international training in inspection and supervision practices, approaches and methodologies 5. Internal and external network in operation. Development of support system for the functions performed by CNBV, computerized supervision systems started up</p>	<p>1. Interinstitutional responsibilities clearly defined 2. Units involved assume responsibility to participate actively in the program 3. CNBV maintains a constant dialogue coordination with the IDB. 4. The supervisors, inspectors and analysts incorporate the benefits deriving from methodologies and support systems 5. Timely training courses</p>

## ANNEX

DESCRIPTIVE SUMMARY	QUANTIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTION
<p>of a high-level management identifying priority activities operating plans for each of the of the operating plans</p>	<ol style="list-style-type: none"> <li>1. Named responsible team</li> <li>2. Operating plans agreed on and executed</li> <li>3. Financing of priority activities for strengthening of supervision and training in an estimated amount of US\$8 million</li> <li>4. Financing of priority activities for information technology support in an estimated amount of US\$8 million</li> </ol>	<ol style="list-style-type: none"> <li>1. Progress and completion reports on the operating plans</li> <li>2. Evaluation and monitoring reports</li> <li>3. Requests for authorization of annual commitments and disbursements</li> <li>4. Reports of the monitoring missions</li> <li>5. Periodic evaluation and review of the operating plans</li> <li>6. Review of strategies and reformulation of activities in accordance with lessons learned and development of the financial system and securities market</li> </ol>	<ol style="list-style-type: none"> <li>1. Technical exchanges with opportunities for detailed technical work</li> <li>2. Local and international consultants</li> <li>3. Contractings done in accordance with established procedures</li> <li>4. Responsible team meets on a timely basis</li> <li>5. Information technology equipment available on a timely basis</li> <li>6. International training courses available</li> </ol>

ANNEX II  
OPERATING PLANS

The operating plans for each period will include, if necessary, the following information:

- (1) specific objectives and goals to be achieved by the implementation of the activities;
- (2) the plan of activities to be carried out, which must include a specific provision for the preparation of the next operating plan;
- (3) a schedule of work with the programmed sequence of activities, which must also be submitted by investment categories (procurement, consulting services, basic and advanced training, etc.);
- (4) procurement and contracting plan, specifying the pertinent procurement and contracting procedure;
- (5) proposed terms of reference, schedules and costs for the subcontracting of consulting services, if any;
- (6) proposed terms of reference, schedules and costs for the organization and subcontracting of courses and seminars, if any;
- (7) plan of activities for exchange and training visits, if any;
- (8) justification, schedules and costs for the procurement of information technology equipment and programs, if any;
- (9) financing plan showing source (IDB funds and local counterpart funding) and use of funds by expenditure categories (procurement, consulting services, basic and advanced training, etc.);
- (10) with the exception of the first operating plan, a report will be included on the use of program funds for the execution of the preceding operating plan, and specifically, of those funds used for maintenance in said period of time;
- (11) monitoring indicators (benchmarks), and indicators for evaluation of achievements;
- (12) CNBV unit or units that will be responsible for preparing short-lists; publication of notices; bid selection and evaluation; contracting of consultants and procurement of goods; supervision of the performance of the contracts with the consultants and specialized firms; preparation of the evaluation reports, submission to the Bank of all pertinent information;
- (13) CNBV unit or units that will be responsible for maintenance of the equipment acquired with program funds, including maintenance plan and resources to finance that plan;
- (14) with the exception of the first operating plan, a report is to be submitted on the execution of the preceding operating plan, based on the previously agreed monitoring indicators and indicators for evaluation of achievements.



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## PROPOSED RESOLUTION

MEXICO. TECHNICAL COOPERATION LOAN \_\_\_/OC-ME  
TO NACIONAL FINANCIERA S.N.C.  
(Support for the Comisión Nacional Bancaria y de Valores of Mexico)

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 Nacional Financiera, S.N.C., as Borrower, and the Estados Unidos Mexicanos, as Guarantor, for the purpose of granting the former a financing to cooperate in the execution of a project to support the Comisión Nacional Bancaria y de Valores of Mexico. Such financing will be for the amount of up to US\$8,000,000, which are part of the resources of the Single Currency Facility of the Ordinary Capital, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.