

SUPPORT FOR CAPITAL MARKET DEVELOPMENT

(TC-96-01-34-6-UR)

EXECUTIVE SUMMARY

**BENEFICIARY AND
EXECUTING AGENCY:** Central Bank of Uruguay (BCU)

OBJECTIVES: The objective of the program is to contribute to consolidating and deepening Uruguayan capital markets by supporting the development of the BCU's regulatory and supervisory capacity over the securities and insurance markets. This will be achieved through actions aimed at: (i) strengthening the supervisory and regulatory capacity of the BCU's Superintendency of Insurance and Reinsurance (SSyR); (ii) promoting diversification in the supply of products and increased competitiveness in the insurance and reinsurance markets; (iii) strengthening the regulatory and supervisory capacity of the BCU's securities market control department (ACMV); and (iv) promoting an expanded number of companies trading securities on the country's stock exchanges and diversifying the range of negotiable instruments traded on those exchanges.

FINANCING:	Modality:	Donation - Window I
	Beneficiary:	US\$ 900,000
	MIF:	US\$1,336,100
	Total:	US\$2,236,100

**SPECIAL
CONTRACTUAL
CONDITIONS:** Prior to disbursing the funds, the BCU must: (i) appoint an official, with the Bank's nonobjection, to head the program; (ii) select the consultant who will act as program coordinator; (iii) provide the physical infrastructure required for executing the operation; (iv) assign the necessary personnel to work in the program design and implementation stage; (v) it must also be committed to: (a) making the corresponding contributions, on a timely basis and in due form, to sustain the reforms and improvements relating to the activities provided for in the program once the Bank's support has terminated; and (b) assigning the necessary personnel on a timely basis to operate and administer the new systems, mechanisms and procedures being established.

**EXCEPTIONS TO
POLICY OR
PROCEDURES** None.

I. COUNTRY ELIGIBILITY

A. Country Eligibility

- 1.1 On October 6, 1993, the Donor Committee declared the Eastern Republic of Uruguay eligible for all types of financing under the Multilateral Investment Fund (MIF).

B. Project Eligibility

- 1.2 The general objective of the proposed project, to contribute to the consolidation and deepening of capital markets by supporting the development of regulatory and supervisory capacity over the country's securities and insurance markets, is consistent with the MIF's objectives of promoting private sector development, to the extent that this requires, as a necessary condition, the existence of a transparent and sound financial system.
- 1.3 Specifically, the proposed operation is consistent with the financing criteria set out in Section 2 of the Establishing Agreement of the MIF, which provides, among other things, for the possibility to grant financing using that fund's resources, to government entities of eligible countries, to support the development of financial systems, specifically by establishing minimum prudential standards and strengthening the capabilities of the supervisory institutions.

II. BACKGROUND

A. Reference framework

- 2.1 The Central Bank is an autonomous entity with technical, administrative and financial autonomy. Its present Charter, approved by Law No. 16,696 of March 30, 1995, establishes, among other institutional objectives, that of promoting and maintaining the soundness, solvency and proper operation of the national financial system, with authority to regulate and control financial intermediation institutions and insurance companies, through services involving the Superintendency of Financial Intermediation Institutions and the Superintendency of Insurance and Reinsurance (SSyR). ^{1/}

^{1/} Law 16,426/93 significantly deregulated the activities of the insurance market by permitting private insurance companies to handle most insurable risks, many of which until that time had been under the monopoly of the State Insurance Bank. The same law created the SSyR within the BCU as a regulatory entity for that market.

- 2.2 In addition, the recently approved reform laws on social security, the securities market and investment funds assign new responsibilities to the Central Bank of Uruguay (BCU) in matters relating to financial control and regulation. For purposes of addressing the aforementioned tasks, the securities market control and social security savings funds administration control departments were created within the institution, resulting in a reorganization of the agency's material and human resources within a short period of time, which required a dual effort: the organization of new services and the strengthening of existing services.
- 2.3 Within the context described above, the focus of attention of this program is on the development of capital markets in Uruguay, through support for strengthening the administrative capacity of the SSyR and the securities market control department (ACMV) and other BCU services. It does not include support for the AFAP control department, since this service has technical assistance available to it under the social security reform program (921/OC-UR).

III. THE PROJECT

A. Objectives

- 3.1 The program's objective is to contribute to the consolidation and deepening of capital markets in Uruguay through support for the development of regulatory and supervisory capacity over the securities and insurance markets. This would be achieved by: (i) strengthening the supervisory and regulatory capacity of the Superintendency of Insurance and Reinsurance (SSyR); (ii) promoting diversification in the supply of products and increased competitiveness in insurance and reinsurance; (iii) strengthening the supervisory and regulatory capacity of the ACMV; and (iv) promoting an increase in the number of companies trading securities on the country's stock exchanges and a diversification in negotiable instruments.

B. Subprograms and basic components (US\$1,336,100)

- 3.2 The proposed program will include two areas of activities: (a) development of the insurance markets; and (b) development of the securities market, involving the components described for each case below. A technical coordination component is also described, for purposes of ensuring the timely and appropriate execution of the various areas provided for in the program.

1. Development of the insurance market (US\$439,800)

- a. **Strengthening the SSyR's supervisory and regulatory capacity:** the following would be carried out under this component: (i) holding seminars on advanced control methods; (ii) evaluating, designing and implementing an information system suited to the SSyR's supervisory function; (iii) implementing a methodology for calculating accident rates in the motor vehicles division; (iv) designing and implementing regulations to define the activities of external and internal auditors; and (v) analyzing current control methods in order to determine their effectiveness and review the mechanisms for exercising enforcement power.
- b. **Support for diversifying the supply of products and increasing competitiveness.** Execution of this component will include the following activities: (i) reviewing the status of the external markets, particularly MERCOSUR, and studying the mechanisms for promoting growth in off-shore production; (ii) reviewing current law as it relates to insurance matters and proposing alternatives for improving it; (iii) undertaking studies for the research and development of products or categories not covered locally, with an emphasis on civil liability, medical and health, social security and worker coverage for purposes of strengthening the control body in its product-licensing process; (iv) designing a strategy to promote increased private-sector participation in categories currently provided solely by the State Insurance Bank (BSE), in order to increase the sector's competitiveness; and (v) promoting the dissemination of technological advances in insurance by means of conferences, seminars, etc., directed to agents active in this sector.

2. Development of the securities market (US\$796,300)

- a. **Strengthening the supervisory and regulatory capacity of the securities market control department.** The funds for this component will be used: (i) to review the existing regulatory framework with a view to incorporating new standards for improving and consolidating capital markets; (ii) to review and adapt the current control methods; (iii) to review and adapt the structural and functional organization of the ACMV; (iv) to adapt the information provided by the agents and automate its processing, thereby establishing a completely computerized information processing system; (v) to regulate with more precision the criteria for submitting accounting statements and actions by auditors in the issuing companies and market agents subject to supervision (e.g., securities markets,

securities agents, mutual funds, etc.); and (vi) to train ACMV employees to carry out their new duties.

- b. **Expanding the number of issuing companies and diversifying the supply of negotiable instruments.** The funds for this component, in which the active participation of the country's securities exchanges is anticipated, will be allotted: (i) to perform an updated diagnostic of the reasons for the low levels of participation by the country's largest companies in the securities market; (ii) on the basis of the preceding diagnostic, to develop a strategy to increase the number of corporations that issue securities and to gain greater secondary liquidity to attract a larger number of investors; (iii) to design a strategy to introduce to the market a broader range of investment alternatives; (iv) to study and propose a payments, clearance, custodial and securities delivery system, in order to implement a centralized mechanism which, while facilitating and streamlining operations, protects the security and transparency of the transactions; and (v) to develop a proposal for information campaigns to improve investor education.

3. Technical and administrative coordination (US\$100.000)

- 3.3 Under this component, funds will be allocated to engage a consultant to serve as administrative and technical coordinator for the project. This individual must be a professional with broad experience in these areas. His duties will be to manage the execution and coordination of the various project components. The consultant will work with the project manager to be selected by the BCU. Both will require the Bank's nonobjection.

IV. EXECUTING AGENCY, EXECUTION MECHANISMS, PROJECT READINESS AND PROJECT BENEFICIARIES

- 4.1 The Central Bank of Uruguay (BCU) will be the executing agency and will benefit from the assistance to be offered through this operation. As a result of the analysis that has been carried out, it is assumed that the entity will receive the necessary funds and institutional capacity on a timely basis to adequately execute the proposed project.

1. Execution mechanisms

- 4.2 The SSyR and the ACMV, as the case may be, will be directly responsible for executing the various project components. The project's operational (logistical and administrative aspects) and

technical coordination will be the responsibility of a specialized consultant to be engaged with funds from this operation.

2. Project readiness

- 4.3 The project is ready for immediate execution. The detailed description of the activities of each component, their estimated cost, and their execution schedule have all been identified. The terms of reference for engaging all of the consultants that it is expected will be required for executing the program have also been prepared.
- 4.4 The total program execution period is expected to be 36 months of actual work. The disbursement period has been set at 42 months.

3. Beneficiaries

- 4.5 The BCU's SSyR and ACMV departments will be the direct beneficiaries of the operation. However, the most significant benefit will be the one obtained by the economic agents which, for purposes of efficiently carrying out their activities, depend on the use of the markets, the regulation and supervision of which they hope to see strengthened since this is expected to yield greater solvency and transparency in these markets.

V. COSTS AND FINANCING

- 5.1 The total project cost is calculated at the equivalent of US\$2,236,100. Of this amount, US\$1,336,100 will be contributed by the MIF through its window I, on a nonreimbursable basis. The remaining US\$900,000, which constitutes local counterpart funds, will be provided by the BCU. The expenses to be covered by the counterpart funds break down as follows: consultants (20%); value added tax for consulting fees of all consultants to be engaged (21%); compensation for full-time staff involved in the project (48%); and equipment and other additional project expenses (including software) (11%).
- 5.2 A revolving fund will be established in an amount of up to 10% of the financing.
- 5.3 The following table shows the various project components and their anticipated costs.

COST OF THE COMPONENTS AND ACTIVITIES
(In US\$)

COMPONENT/ACTIVITY	MIF	LOCAL	TOTAL
- Insurance market development			
Strengthening, supervision and regulation	327,000	375,200	702,200
Diversification of supply and increased competitiveness	112,800	40,000	152,800
SUBTOTAL	439,800	415,200	855,000
- Securities market development			
Institutional strengthening	454,000	276,600	721,600
Diversification of supply of the securities market	342,300	181,200	523,500
SUBTOTAL	796,300	448,800	1,245,100
- Technical coordination and administration	100,000	36,000	136,000
TOTAL	1,336,100	900,000 ^{1/}	2,236,100

^{1/} The BCU will cover all contingent expenses incurred. These expenses cannot be quantified at this time.

- 5.4 The project costs to be financed by MIF include only US\$70,000 (3%) for equipment purchases. It must also be noted that items relating to contingencies are not included since, if they do arise, they would be covered by the BCU with its own funds in addition to those originally committed as counterpart funds.

VI. PROGRAM JUSTIFICATION

A. Justification

- 6.1 The proposed program corresponds to the government's 1995-2000 development strategy, which is focused on a complete macroeconomic adjustment program with a long-term horizon, aimed at improving economic competitiveness. The Bank's strategy for Uruguay supports the government in its objective of promoting private investment as an engine for economic development. The growing competitiveness of MERCOSUR and areas outside the region makes it imperative to carry out structural economic reforms as well as to increase the efficiency and deepening of the financial system in its various markets.
- 6.2 Promoting the consolidation and deepening of capital markets by strengthening the capacity to regulate and supervise the country's securities and insurance markets is a direct result of the

legislative reforms introduced in recent years in these areas, with a view to promoting the development of the country's financial markets and is an essential condition for the success of such reforms.

- 6.3 In this sense, the proposed program is consistent with the guidelines that have been set forth, insofar as strengthening the BCU's capacity to regulate and supervise the securities and insurance markets tends to: (i) ensure the sufficient transparency and solvency of such markets; and (ii) stimulate their modernization, integration, competitiveness and deepening of these markets.

B. Risks

- 6.4 In general, the program's success primarily requires the firm commitment of the BCU, both for its efficient and timely execution and for adequate implementation of the recommendations and proposals made by the consultants.
- 6.5 One of the major risks facing the project is that there is not sufficient time and the human and material resources needed for appropriate execution of the project. In order to resolve this, it shall be contractually established, as a condition precedent to disbursement of the funds, that the BCU formally commit to providing sufficient resources on a timely basis. This commitment shall also extend to providing the resources needed to ensure adequate maintenance of the improvements introduced under the program, which constitutes the most significant potential risk of the proposed program.

VII. PERFORMANCE CRITERIA AND EVALUATION OF PROJECT RESULTS

- 7.1 The criteria for evaluating project performance will be based strictly on timely completion and sufficient quality of the various products established as a result of the activities to be carried out under the various project components. A description of these outputs/products is included in the logical framework (Annex I). The rate of advance of the program, as well as its successful conclusion, will be evaluated by analyzing the semi-annual progress reports and final report which the executing entity must submit to the Bank.

VIII. EXCEPTIONS TO POLICIES OR PROCEDURES

- 8.1 This project requires no exception to the current policies or procedures for this type operation.

IX. CONTRACTUAL CONDITIONS

- 9.1 Before disbursing the funds, the BCU must: (i) appoint an official approved by the Bank to manage the program; (ii) select the consultant who will act as program coordinator; (iii) provide the physical infrastructure needed to execute the operations; (iv) allocate the necessary number of personnel to act in the program's design and implementation stage; (v) it must also commit to the following: (a) providing the corresponding contributions on time and in such a way as to sustain the reforms and improvements arising from the activities provided for in the program, upon termination of the Bank's support; (b) providing for timely assignment of the personnel needed to operate and administer the new systems, mechanisms and procedures that are implemented.

X. SOCIAL AND ENVIRONMENTAL IMPACT

- 10.1 The profile was forwarded to CESI on June 30 for information purposes, and no comments have been received.

**SIMPLIFIED LOGICAL FRAMEWORK FOR A PROJECT TO SUPPORT CAPITAL MARKET DEVELOPMENT
(TC-96-01-34-6-UR)**

PROGRAM OBJECTIVE

to consolidation and deepening of the Uruguayan capital markets through support for the development of the BCU's capacity to regulate and supervise the insurance and

COMPONENTS	ACTIVITIES	RESULTS/PRODUCTS
Development of the insurance market		
Strengthening the regulatory capacity	(i) Hold two seminars on advanced control methods.	Employees better trained to apply more advanced control procedures.
	(ii) Design and select the software and define the proper hardware for the supervisory task.	Efficient information processing systems implemented and functioning.
	(iii) Implement a methodology for calculating the accident rates of the motor vehicles branch, for correct determination of the technical reserves.	Procedure for calculating accident rates implemented and functioning.
	(iv) Design and implement standards to regulate the activities of the internal and external auditors of asset insurers.	Approval of clear and effective rules for performing audits for registering and controlling auditors.
	(v) Review the current control methods and mechanisms for exercising the SSyR's enforcement power.	Appropriate control methods and enforcement mechanisms to ensure proper market operation.
Diversifying the supply of products and competitiveness of the insurance and capital market.	(i) Analyze the method of promoting off-shore production by local insurance companies as a means of promoting operational liberalization in MERCOSUR.	Proposed actions to ensure competition under equal conditions with foreign companies that cover Uruguayan domestic market.
	(ii) Review the current laws and regulations governing the activity and propose reforms to promote diversification and competitiveness.	Proposals for reforms to ensure a modern regulatory framework that facilitates competitiveness in new categories and markets.
	(iii) Carry out research and development studies of new products or categories not covered in the market, with emphasis on civil liability, and medical and health, retirement and labor coverage.	Strengthen the SSyR's product licensing process, promote a system that allows providing users adequate coverage for products of significant development or social importance in order to diversify the market.
	(iv) Design a strategy to promote increased participation by private insurers in categories currently being provided exclusively by the BSE.	Increase diversification and competitiveness in the market.
	(v) Promote the dissemination of advances in insurance techniques, through conferences, seminars or courses aimed at operators.	Training of operators capable of promoting the development of new coverage and marketing techniques.

Securities market development		
the supervisory and regulatory capacity of the the control department (the BCU's ACMV)	(i) Review the current regulations and propose adjustments to improve their efficiency based on the need to consolidate the capital markets.	Implementation of a regulatory framework to facilitate diversity and to contribute to improving the efficiency and timeliness of the control measures.
	(ii) Review and adjust the current control methods.	Efficient information processing systems implemented and functioning.
	(iii) Survey the department's organization and resources and propose a functional model consistent with market prospects.	Implementation of an efficient organization that adequately administers the supervisory duties without excessively increasing its own costs and those of the market.
	(iv) Review and adjust information provided by operators and subsequent processing implementing a fully computerized information system.	Implementation of an efficient information system by computerized media from receipt to processing of data.
	(v) Regulate the activities of audit professionals in companies in the sector.	Implementation of a regulatory system for professional area which provides for reliable accounting statements and reports.
	(vi) Train unit employees to carry out their new tasks.	Implementation of a training program that allows them to have resources consistent with the requirements of the concept of supervision.
the number of issuing companies and diversification in the supply of negotiable in the securities market (to be executed by the with the active participation of the country's changes)	(i) Review and update the study carried out for the 1991 financial sector loan by a consultant from the U.S. Securities Exchange Commission, in order to identify the reasons why so few companies place their issues on the securities markets.	Perform a current diagnostic of what is preventing development of the market from the perspective of private companies.
	(ii) Design a strategy to obtain greater market share by Uruguay's largest companies.	Implementation of a strategy to gain participation by number and greater diversity of employees and volume of instruments, achieving higher secondary liquidity through investors.
	(iii) Analyze the possibility of introducing products and instruments traded in other markets to the Uruguayan market.	Action plan to offer a broader menu of investment options in options or derivatives, which will provide a strong impetus to the local market.
	(iv) Design, propose and introduce a payment, clearing, custody and securities issuance system.	Implement a system that allows avoiding the printing of certificates [láminas], a method that increases costs and the level of complexity in safekeeping, transfer and sale of securities. Related to this, implement a centralized payment system that facilitates and guarantees the transfer of certificates and securities.
	(v) Identify the existing shortfalls in investor information and develop a communications campaign to correct them.	Investors better prepared to understand the rules of the market thereby furthering transparency and competition in the market.
Technical and administrative coordination		
	(i) Engage one consultant who would be responsible for the technical and administrative coordination of executing the various program components.	Ensuring that the execution of the various program components is carried out in a timely and appropriate fashion.

PROPOSED RESOLUTION

**URUGUAY. NONREIMBURSABLE TECHNICAL COOPERATION FOR A
PROGRAM TO SUPPORT THE DEVELOPMENT CAPITAL MARKETS**

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the Central Bank of Uruguay and to take such additional measures as may be pertinent for the execution of the project memorandum referred to in Document MIF/AT- with respect to a technical cooperation program to support the development of capital markets.

2. That up to the amount of US\$1.336.100, or its equivalent in other convertible currencies, is authorized for the purpose of this resolution, chargeable to the resources of the Technical Cooperation Facility of the Multilateral Investment Fund.

3. That the above-mentioned sum is to be provided on a nonreimbursable basis.