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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

MEXICO

TECHNICAL NOTE ON ORGANIZATIONAL ARRANGEMENTS FOR EFFECTIVE FINANCIAL SYSTEM REGULATION, SUPERVISION AND POLICYMAKING NOVEMBER 2006

THE WORLD BANK
FINANCIAL AND PRIVATE SECTOR DEVELOPMENT
VICE PRESIDENCY
LATIN AMERICA & THE CARIBBEAN VICE PRESIDENCY

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS
DEPARTMENT

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GLOSSARY

AFOREs	Private pension fund administrators
AMIB	<i>Asociación Mexicana de Intermediarios Bursátiles</i>
BOM	Bank of Mexico
CNBV	National Banking and Securities Commission
CNSF	National Insurance and Sureties Commission
CONSAR	Pension Fund Commission
FIRA	Trusts to support agriculture established by the Federal Government. Managed by BOM
FSAP	Financial Sector Assessment Program
IMSS	Mexican Institute of Social Security
INFONAVIT	Institute of the National Housing Fund for the Workers
NAFIN	Nacional Financiera, Banca de Desarrollo
SHCP	Secretary of Finance and Public Credit
ISSTE	State Employees Security and Social Services Institute
MEXDER	Mexico's Derivatives Market
SHF	Federal Mortgage Society, a state development bank

EXECUTIVE SUMMARY¹

1. **The 2006 FSAP Update mission found Mexico has made significant strides in increasing transparency and market discipline, and in strengthening the institutional framework for financial oversight since 2001.** Reforms implemented encompassed the legal framework, operational arrangements, and information systems, as well as transparency and information disclosure aspects. There was a significant modernization of the regulatory framework, inter-agency coordination improved, and significant steps were taken towards consolidated supervision. This, together with the limitation of the previously unlimited guarantee on bank liabilities, significantly boosted market discipline. The professionalism of the regulatory and supervisory agencies is well recognized in the markets.
2. **However, further reforms are needed to better match financial oversight and policy arrangements to evolving market realities—strongly influenced by conglomeration and globalization—and to close regulatory and supervisory gaps.** Shortcomings in the current silo-based regulatory framework point to the need to strengthen consolidated supervision of financial groups; to further clarify and enhance the roles and responsibilities of the Commissions in the regulation of financial entities and markets; to step up and better formalize inter-agency coordination; to further de-link the regulatory and supervisory system from the political cycle; to allow for a more agile approval process for new financial products; to reduce regulatory compliance costs; and to enhance the regulatory institutions' preparedness to deal with individual or systemic bank (and financial group) instability. There is also the need to strengthen the SHCP's role in designing medium and long term development strategies for the financial sector attuned to evolving market realities, and to assign responsibility for oversight of competition in the financial sector to a specific agency (BOM oversees competition in the payment system).
3. **A building block approach to reform is recommended.** This means moving progressively toward full autonomy (operational, political, and budgetary) for the Commissions, strategically defining the timing and pace of changes in accordance with the ability to secure strong political support for reforms and to enact a robust legal framework. Successful implementation critically depends on the pre-existing culture of inter-institutional cooperation, and on a reasonable expectation that change will be managed consistently over a period of at least five to six years until the process bears fruit and builds resilience to overcome the effects of political cycles. The building block approach allows to improve ongoing regulation and supervision and to ensure that pre-conditions for successful

¹ Prepared by Ruth de Krivoy.

organizational change management will be met at each stage. A change champion will be required to steer the process and convey to all stakeholders the message that organizational change is a carefully planned process, rather than an event or a quick fix. Initial emphasis is placed on strengthening inter-agency coordination and enforcement capabilities within the existing legal framework. Changes requiring legal reforms are proposed as subsequent phases in the action plan. Opportunities to improve legal protection for regulators and supervisors should be explored and implemented throughout.

4. **The first reform building block aims at improving supervisory operations and inter-agency coordination, within the current legal framework.** This includes enhancing the contribution of the Commissions' boards to the regulatory and supervisory process and to interagency coordination by means of a strategically designed set of committees at board level, where board members and management interact, focus on key issues, build trust, and strengthen inter-institutional links through a common experience in dealing with regulatory and supervisory challenges. Board members representing BOM are called to play a critical role in this process as their tenure is not determined by political cycles. As a complement, MOUs to be signed by the Commissions setting clear responsibilities, accountabilities, and operational rules covering information exchange and supervisory decision making, are recommended as a means to help align incentives and allow for coordinated responses to problems at this stage.

5. **A second building block aims at strengthening the Commissions' operational autonomy, with clear powers throughout the life cycle of financial institutions.** This requires a legal reform that suitably realigns powers and responsibilities for SHCP, CNBV and CNSF (following the model already in place for pensions and securities markets) and creates the framework for a more structured approach at inter-agency coordination, while maintaining the Commissions' current status as decentralized agencies of SHCP. This will allow each agency to discharge its duties more effectively. It will also boost inter-agency coordination by further aligning the incentives of Commission representatives at every step along the way (boards, board committees, inter-agency coordination committees, etc.).

6. **A third building block aims at moving towards full consolidated supervision of financial conglomerates.** This requires legal and operational reforms, including giving the regulator the power to presume the existence of a group; setting capital requirements for the group in addition to its individual entities; setting the role and powers of a lead supervisor for the group who should be able to oversee the holding company *and* the individual entities; eliminating barriers to exchange information, and allowing for joint—rather than the simultaneous—inspection visits. This legal reform would also aim at simplifying the regulatory framework for financial groups.

7. **A fourth building block aims at establishing full autonomy for the Commissions (operational, political, and budgetary) through appropriate legal and constitutional reforms.** These reforms must also establish the financial sector regulators and supervisors'

accountability. As top level agencies in the executive branch, they should report directly to the highest political authority in Mexico and be accountable to the congress. Annual reports stating the agency's goals, accomplishments and shortfalls, supervisory actions taken, the cost of bank failures (if any), and the financial condition of banks and other financial institutions could be submitted to and analyzed by a Finance Committee of Congress which would have the authority to regularly summon the supervisor for hearings on supervisory strategies and decisions. Transparency will help establish accountability.

8. **Contingency planning exercises to prepare for the possible failure of an individual institution, a systemically important financial group, or a systemic crisis are also recommended.** These would involve a small number of high-level officials from the SHCP, BOM, CNBV, CNSF, CONSAR, and IPAB.

I. OVERVIEW

9. **The objectives of this paper are twofold:**

- To assess the effectiveness of current organizational arrangement and distribution of functions across agencies in achieving effective prudential supervision and financial sector development.
- To make recommendations to enhance the readiness of the authorities to deal with current and foreseeable challenges.

10. **The paper focuses on assessing the suitability of the current organizational arrangements and distribution of functions among policy makers, the SHCP and the BOM, and the CNBV and CNSF as key supervisors and regulators for the core of the financial sector and the payment system.** The issues central to this analysis are: autonomy (operational, political and budgetary), powers and functions, enforcement capabilities, and inter-institutional coordination.

11. **The paper is based on the findings of the 2006 FSAP Update mission.** Given time constraints and the limited breadth of the needs assessment conducted in this exercise, an in-depth analysis of possible alternatives in implementing solutions to address the vulnerabilities identified by the mission has not been attempted. Where appropriate, future avenues of exploration in the form of an agenda for institutional reform are recommended. The paper does not attempt to cover the historical evolution and rationale of the current Mexican organizational arrangements and legal framework. Regulatory problems with no bearing on the challenges faced in terms of the organizational arrangements for financial sector regulation and supervision are not covered.

12. **The 2001 FSAP identified problems of insufficient clarity and duplication in the distribution of regulatory functions across agencies, fragmentation of supervisory powers, and lack of formal autonomy of regulatory agencies, hurting the agencies'**

accountability and credibility, and hampering their ability to enforce regulations.

Fragmentation of supervisory powers weakened accountability and enforcement in the CNBV and CNSF. The CNBV was found to lack adequate autonomy, as a result of certain regulatory powers being outside the agency, chiefly in the hands of SHCP; the Commission also lacked budgetary autonomy. The CNSF also suffered from the fact that the SHCP had the ultimate say on licensing and other insurance sector regulations, and similarly lacked budgetary autonomy. Given the Commissions' governance structure and the manner in which their presidents are named, political interference in decision-making and politically imposed budgetary constraints were attendant problems. The need to accelerate the move towards risk-focused supervision was identified. The CNBV also needed to intensify efforts to boost its credibility, eroded during the 1994-1995 banking crisis.

13. **The 2006 FSAP Update mission found that substantive progress was made since then to adapt the institutional arrangements to the new conditions in the Mexican financial market.** Reforms encompassed legal, operational, and information systems, as well as transparency and information disclosure aspects. There was a significant modernization of the regulatory framework; inter-agency coordination improved, and significant steps were taken towards consolidated supervision. Today, the professionalism of the regulatory and supervisory agencies is well recognized by the markets. However, further reforms are needed to better match financial oversight and policy arrangements dynamically to evolving market realities, to move towards full autonomy of the regulatory agencies, and to close regulatory and supervisory gaps, especially on consolidated supervision.

II. EVOLVING MARKET TRENDS

14. **The Mexican financial system is diverse.** The financial system includes commercial banks, insurance companies, pension funds, broker dealers, investment banks, development banks, non-deposit taking credit institutions (Sofoles), and brokerages. The presence of large foreign-owned financial conglomerates is dominant. Universal banks account for 49 percent of financial system assets. The banking sector exhibits a high degree of concentration (the three largest institutions account for close to 60 percent of the banking sector's assets) and a high degree of foreign ownership (representing over 80 percent of all banking assets as of May 2006). Development banks, privately managed pension funds (AFOREs) and mutual funds account for 13, 13, and 11 percent, respectively, of financial system assets. Insurance, non-bank banks (Sofoles) and other financial institutions are making important strides and account for the other 14 percent. Sofoles do not take deposits and were licensed by SHCP (considering the opinion from CNBV and in the case of foreign ownership also from BOM) to grant credit to specific segments of the economy². The bulk of

² The legal framework for Sofoles, Leasing Companies (*Arrendadoras*) and Factoring Houses (*Casas de Factoraje*) was modified on July 18, 2006. Their operations were deregulated and they were given a seven-year lifespan. Authorities no longer grant this type of licenses and this type of activities can be freely carried out.

(continued)

the financing of mortgage Sofoles comes from the SHF, a development bank, although they have started to tap the private market and, in the last two years, several of the large mortgage Sofoles have been acquired by private banks. FIRA and NAFIN have played an important role in the development of agricultural- and SME-oriented Sofoles.

15. **A large and growing portion of financial sector assets is now managed by financial groups, mostly foreign-owned.** The financial groups are increasingly being managed as groups –by product and business lines– rather than by legal entities. The large multinational financial groups are involved in virtually all the salient lines of financial business (banking, insurance, asset and fund management, brokerage, pension fund administration, etc.) and dominate the Mexican financial landscape; however, they are not necessarily dominant in all specific sector (i.e., insurance).

III. CURRENT ORGANIZATIONAL ARRANGEMENTS

16. **The financial system is overseen by multiple regulators within a silo-based organizational framework.** The SHCP sets regulatory policy for the financial system, particularly license granting and removal for banks. The CNBV is the supervisor and regulator for banks, other credit institutions, and securities markets. The BOM has regulatory responsibilities, especially regarding money, foreign exchange, and derivatives markets, as well as payment systems and financial operations and product characteristics. CONSAR oversees AFOREs and the CNSF oversees insurance and surety companies. The legal status of the CNBV, CNSF and CONSAR is that of decentralized agencies—*órganos desconcentrados*—of SHCP. The institutional framework also includes the Mexican Association of Securities Intermediaries (AMIB), a private organization, which administers qualification exams for employees of brokers, mutual funds, and banks engaged in the sale of securities, the Stock Exchange (*Bolsa*) which has private sector participation, MEXDER, the Mexican derivatives market, also with private participation, and IPAB, the bank resolution and deposit insurance agency that is also charged with disposing of the distressed assets inherited from the 1994 Tequila crisis. Two consumer protection agencies also have a saying over certain segments of the financial sector: CONDUSEF in financial institutions, and PROFECO in the case of the Sofoles.

Table 1. Mexico: Institutional Architecture for Financial Regulation and Supervision

	Banks and Deposit- taking Institutions	Brokerage Firms	Mutual Funds	Insurance and Surety	AFORE	Non-banking Institutions
SHCP (1+3)	■	■	■	■	■	■
Banxico	■	■	■	■	■	■

The law also provides for other non-regulated entities called Sofomes (*Sociedad Financiera de Objeto Múltiple*) which do not require licensing by the financial authorities.

CNBV	■	■	■	-	-	■
CNSF	-	-	-	■	-	-
CONSAR	-	-	-	-	■	-
Profeco	-	-	-	-	-	■
Condusef	■	■	■	■	■	■

17. **The regulatory and supervisory system is complex and compartmentalized.** The responsibilities of the CNBV and CNSF are curtailed by the regulatory powers of the SHCP and BOM described above. Fragmented lines of responsibility in decisions affecting the life cycle of financial institutions (licensing, regulation, ongoing supervision, sanctions, and failure resolution), and a complex and cumbersome system of checks and balances, lead to regulatory overlaps and gaps, and high compliance costs, except for the securities market area where the CNBV has been given the power to decide and implement decisions affecting the whole life cycle of institutions by the 2004 Securities Market Law.

A. Inter-Agency Coordination

18. **Inter-agency coordination rests largely on inter-locking boards, which serve as a high level communication and coordination mechanism.** The board of CNBV includes the agency's president, appointed by and reporting to the SHCP, and ten board members appointed as follows: five are appointed by and serve on behalf of the SHCP; three by BOM; one by CNSF, and one by CONSAR. Alternates are appointed following the same rules. Similarly, the board of CNSF is presided over by a SHCP appointee and includes nine board members as follows: four appointed by the SHCP who may be CNSF civil servants and two also appointed by SHCP who cannot be part of CNSF staff; one by CNBV; one by BOM; and one by CONSAR. It also includes two CNBV Vicepresidents appointed by the President of the agency. Alternates are appointed following the same rules. The board of CONSAR includes the Governor of BOM; the Undersecretary of SHCP; the General Directors of IMSS, ISSSTE, and INFONAVIT; the Presidents of CNBV and CNSF; two labor representatives and one representative of the employers. The inter-locking boards system is a well-intended improvement over past arrangements. However, decision making is often hurt by the fact that board members are high ranking officials, burdened by heavy schedules, whose primary function is to protect the interest of the institution they represent. Overlapping responsibilities may lead to conflicts of interest and frictions, and hinder the board's efficiency – especially when it comes to problem solving.

19. **Operational coordination between CNBV, CNSF, SHCP and BOM is conducted mostly through *ad hoc* meetings convened by the agency facing the need. Responsibility over the results of these meetings is often blurred and follow up is largely up to the parties with the most pressing urgency.** Overlapping responsibilities also bring conflicts of interest to bear at this level and may hinder the exchange of information and affect the decision making process at an operational level. Informal coordination mechanisms often help overcome barriers, but results become overly dependent on personal relationships and trust, and may be influenced by day-to-day politics. It is worth noting that coordination

between banking and securities regulators improved considerably after the merger between the Banking and Securities Commissions in 1995. This reflects sustained efforts by CNBV leadership.

20. **Formal checks and balances operate through a complex system of binding and nonbinding opinions to be issued by SHCP, BOM, CNBV, CNSF and CONSAR, as a legal prerequisite for numerous decisions throughout the life cycle of the financial institutions.** The cross opinions system is well-intended but, in practice, it has led to adverse consequences and unduly burdens the regulatory process. Even though many opinions are not binding on the requesting agency, differences in opinions among agencies can result in major delays in the issuance of regulations or in clarifications of the interpretation of laws and regulations. The problem is further complicated by the fact that agencies are not always time bound to issue their opinions and that there is no general interpretation of administrative silence. In practice this system is unduly cumbersome, tends to result in the dilution of responsibilities, and unnecessarily hinders the operational autonomy of the Commissions.

B. Impact on Competition and Innovation

21. **Innovation and competition are hurt by complex and burdensome approval processes for new products, especially in the case of hybrids.** All new products are subject to approval by BOM as well as by the specialized supervisory agency, under detailed and restrictive rules following a compliance-oriented regulatory system. BOM has the duty and the power to regulate financial transactions, and must therefore give its stamp of approval to any new product that has or may be perceived to have transactional implications. Decisions are sometimes further delayed by BOM concerns over financial stability. This results in a cumbersome and lengthy approval process that hurts innovation. Indirectly, it also affects competition because strict compliance cultures instilled into some foreign-owned players in the Mexican market by their holding companies and home country supervisors may translate into more cautious behavior towards new product compliance than that of other players in the market.

C. Opportunities for Regulatory Arbitrage

22. **Although considerable progress has been made in leveling the playing field and reducing regulatory arbitrage, there are still certain regulatory inconsistencies which require attention.** In the case of financial groups, capital adequacy requirements are set only at the level of individual entities, not at a consolidated group level, creating opportunities for multiple gearing. In some cases, different norms apply to similar financial products. For instance, there are different rules on margins for banks and exchange houses. In the case of derivatives, banks can offer, negotiate, and invest in these instruments on and off exchange; mutual funds are at present excluded from this market; and AFOREs are allowed to buy and sell derivatives but only on exchange. Similarly, there are insurance products with a savings component which are regulated differently than savings products issued by banks; and there

are mutual fund-like products offered by insurance companies that do not seem to follow the segregation rules applicable to mutual funds proper. Off-shore operations and trusts may also serve as means for regulatory arbitrage.

D. Consolidated Supervision

23. **23. Conglomerate risks in Mexico are mitigated by two factors: the civil-code legal framework and home country supervision in the case of multinational financial groups operating in Mexico.** In fact, the civil-code based Mexican legal framework sets out with great precision permissible activities for each type of financial entity. This creates segmentations that limit conglomerate risks, but in doing so it hinders synergies and financial innovation.

24. **Furthermore, the scope for conglomerate risks inevitably widens as groups increasingly follow a group-wide strategy.** Despite steps taken towards consolidated supervision, including simultaneous visits of supervisors of different agencies, no agency has the power to oversee a financial group and its subsidiaries. As mentioned above, capital adequacy requirements are set only at the level of individual entities, and not at a consolidated group level, thus creating opportunities for multiple gearing. The law does specify that a holding company will be supervised by the agency in charge of supervising the preponderant entity of the financial group, as determined by the SHCP. However, the holding company has a very simple balance sheet and performs no significant financial activity other than being the legal holder of the stock of its member entities. Moreover, the agency in charge of supervising the holding company is in charge of supervising some of the financial entities of the group but does not necessarily have lead responsibility in supervising all the financial entities under the holding. Also, simultaneous inspections fall short of truly joint inspections as each specialized supervisory agency is only entitled to have access to the institutions that fall within its competence and regulations on confidentiality impede information sharing among supervisors. The figure of lead supervisor does not exist in the law. A legal reform is required to develop an adequate regulatory and supervisory view on the financial group and its subsidiaries as a whole.

E. Cross-border Supervisory Reliance

25. **The unusually high degree of internationalization of the Mexican financial system puts a premium on cross-border cooperation among financial regulators and supervisors.** Foreign banking groups account for a significant share of the systemically important conglomerates operating in Mexico. Assessing the incentives of foreign shareholders vis-à-vis the Mexican operation; implementing effective group-wide cross-border consolidated supervision; enhancing cross-border supervisory cooperation; and readying for an efficient resolution process in the case of failure of a foreign-owned systemically-important financial group are all critical to the success of the Mexican regulatory and supervisory agencies in discharging their duties. The CNBV maintains fully

effective and operational MOUs with the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the New York State Banking Department, the Office of the Superintendent of Financial Institutions of Canada, the UK's Financial Services Authority, and the Bank of Spain, among others. Cross-border inspection visits and requests of specific information are carried out under these agreements. Evolving market trends and emerging risks point to the need to enhance the effectiveness of cross-border supervisory reliance and preparedness to deal with problems.

F. Compliance Costs

26. Despite the progress achieved so far in simplifying the regulatory and supervisory framework, there is room for further reducing regulatory compliance costs.

Measures have been taken in order to avoid duplication in the information burden to banks and other financial intermediaries. In 2000, the BOM, the SHCP, the CNBV, IPAB, and CONDUSEF created the Committee for Coordination between Authorities on Financial Information. CONSAR and CNSF joined the Committee more recently. The agencies agreed to share information in order to eliminate duplications on data requirements. Any additional information requirement by any of the members must be cleared by the Committee to ensure that the required information is not already being obtained. The Committee has succeeded in reducing the burden posed by information requirements and many reports were eliminated. However, there is still room for further improvement in: (1) avoiding reporting requirements to multiple agencies and multiple officials in the same agency; (2) standardizing reporting forms; (3) minimizing multiple and uncoordinated inspections; (4) improving timeliness in authorization procedures; and (5) streamlining sanctions across the system in order to correct, where appropriate, for the lack of proportion between violations and sanctions.

27. Compliance costs are especially high in financial groups. They must report to or interact with up to 10 regulatory agencies and numerous government officials (often, more than one in each agency). Problems are compounded by the issuance of numerous, detailed secondary regulations carrying significant sanctions for non-compliance.

IV. RECOMMENDATIONS

28. Areas for further improvement in the current organizational arrangements include clearly defining the mission of each agency involved in financial sector supervision and regulation, especially regarding SHCP, CNBV and CNSF, and eliminating overlaps as a means to enhance the Commissions' operational, political and budgetary independence; improving inter-agency coordination both at operational and policy levels; and minimizing vulnerability to the electoral cycle. There is also the need to continue the efforts to improve information systems in order to overcome remaining fragmentation, inconsistencies, and gaps, and to ensure that manageable data is made available to the appropriate decision making instances on a timely basis. Market realities and trends intensify the need to enhance consolidated supervision of financial groups; to establish capital requirements for financial

groups, in addition to regulatory capital requirements for individual institutions; and to implement an efficient resolution mechanism for banks and financial groups. Inconsistencies between the seriousness of violations and the intensity of the respective sanction need to be mitigated in order to avoid distorting compliance priorities.

29. **Organizational reform should also take into account the need to adapt the medium and long term development strategy for the financial sector to evolving market realities, and to assign the responsibility to oversee competition in the financial sector to a specific agency** (BOM has powers over competition in the payment system).

Goals of organizational reform

30. **Against this background, the goals of organizational reform in Mexico are as follows:** (i) moving towards full autonomy (operational, political, and budgetary) for the Commissions; (ii) streamlining functions and responsibilities; (iii) establishing effective checks and balances; (iv) enhancing enforcement capabilities, and (v) strengthening legal protection for regulators and supervisors.

A. A Building Block Approach Seems Advisable

31. **A one-step move towards establishing a single, integrated, fully independent agency is not advisable, even though it could theoretically seem as a straightforward and simple solution to all problems.** Critical success factors for a “big bang” approach are: strong political footing for reforms; ability to enact a robust legal framework; building on a pre-existing culture of inter-institutional cooperation; and managing change consistently over a period of at least 5-6 years. These pre-conditions need to be built up over time with care and perseverance. Organizational change needs to be and to be perceived as part of a planned and systematic process carried out for organizational improvement and aimed at solving real problems, not simply a quick fix. A change champion, with the right incentives, is also needed to steer the process. Otherwise, organizational reform may fail, at a considerable cost.

32. **A building block approach to reform the organizational arrangements for financial system policymaking, regulation, and supervision is thus recommended.** This means *progressively* moving toward full autonomy (operational, political, and budgetary) for the Commissions, enhancing the Commissions’ governance by including independent directors whose terms do not coincide with the political cycle, strengthening accountability, and eventually merging CNBV and CNSF. Establishing full regulatory and supervisory autonomy for the Commissions implies their separation from SHCP and would have to be accompanied by a reinforcement of SHCP leadership in financial development policy—with emphasis on depth, efficiency, diversity, and breadth of access. The BOM would, in turn, continuously enhance its role regarding systemic stability. Opportunities to improve legal protection for regulators and supervisors should be explored and implemented throughout.

Improvements within the existing legal framework

33. **A first reform building block would focus on operational improvements and more effective inter-agency coordination, within the current legal framework.** This entails at least the following actions: (i) improving board performance at the Commissions' level through more active use of a strategically crafted system of board committees to deal with specific topics, where board members and management interact, develop a common vision on regulatory and supervisory issues, and build trust through team work and successful problem solving; and (ii) strengthening coordination between CNBV, CNSF, and CONSAR through MOUs that set clear responsibilities, accountabilities, and operational rules covering information exchange and supervisory decision making, as well as coordinated responses to problems. Coordination could be further enhanced via a formal interagency coordination process conducted through a high-level working group that meets periodically, follows an agenda, and has strong technical support. Board members representing the BOM are called to play a critical role in this process, as their tenure is not determined by electoral cycles.

Realigning powers and responsibilities

34. **A second building block aims at establishing the Commissions' operational autonomy. This entails a suitable realignment of powers and responsibilities (following the model already in place for pensions and securities markets) and improved coordination, while maintaining the Commissions' current status as decentralized agencies of SHCP.** Legal reforms are required at least in the following areas: (1) transferring many of the regulatory powers currently held by the SHCP to the Commissions, thereby minimizing the burden of the opinions, as was done recently for securities markets under the new Securities Markets Law, and giving the Commissions as broad powers as possible over the life cycle of financial institutions; (2) remaining opinions would be made more agile by setting deadlines and establishing an "administrative silence regime" conducive to action; and (3) independent full time directors could be appointed to the boards of the Commissions at this stage. To complement these changes, the SHCP and the BOM would focus on financial sector development and financial stability policy, respectively. The BOM would assess opportunities to discontinue issuing prudential regulation in areas in which the CNBV has issued its own, and continue its efforts to simplify the regulations it is obligated to issue by law.

Consolidated supervision of financial conglomerates

35. **A third building block aims at implementing consolidated supervision of financial conglomerates.** This requires both legal and operational reforms. Key legal reforms include: giving the regulator the power to presume the existence of a group; setting capital requirements for the group in addition to its individual entities; setting the role and powers of a lead supervisor for the group capable of overseeing the holding company *and* the individual entities; eliminating barriers to exchange of information, and allowing for joint—

rather than the simultaneous—inspection visits. This legal reform would also aim at simplifying the complex and cumbersome regulatory framework for financial groups. Clear rules would allow for more effective coordination between CNBV, CNSF, and CONSAR for the sake of effective consolidated supervision, and would further enhance the cooperative relationships that already exist with regulators and supervisors in other jurisdictions.

Full autonomy and accountability for the commissions

36. **A fourth building block aims at establishing full autonomy for the Commissions (operational, political, and budgetary)** through appropriate legal and constitutional reforms. These reforms must also establish the financial sector regulators and supervisors' accountability. As top level agencies in the Executive branch, they need to be established at the appropriate level in the Mexican institutional hierarchy and become accountable to the Congress. Annual reports stating the agency's goals, accomplishments and shortfalls, supervisory actions taken, the cost of bank failures (if any), and the financial condition of banks and other financial institutions would be submitted to and analyzed by a Finance Committee of Congress which would have the authority to regularly summon the supervisor for hearings on supervisory strategies and decisions. Transparency will help establish accountability.

B. Contingency Planning

37. **Contingency planning exercises to prepare for the possible failure of an individual institution, a systemically important financial group, or a systemic crisis are also recommended.** A small number of high-level officials from the SHCP, BOM, CNBV, CNSF, CONSAR, and the IPAB should participate, from time to time, in detailed contingency planning scenarios (or "fire drills") to more clearly solve coordination problems, develop internal protocols regarding emergency liquidity assistance, and identify shortcomings in the legal, regulatory, and procedural frameworks. These exercises are key to ensure preparedness to better deal with difficult decisions in the event of an individual or systemic bank instability.

C. Change Management

38. **The timing and pace of changes must be subject to the ability to secure strong political support for reforms and to enact a robust legal framework.** Successful implementation critically depends on the pre-existing culture of inter-institutional cooperation, and a reasonable expectation that change will be managed consistently over a period of at least 5-6 years, building resilience to overcome the challenges of electoral cycles. A change champion is required to steer the process.